



THE CHANGING FUNDING ENVIRONMENT IN CLASS ACTIONS

PRESENTATION TO MAURICE BLACKBURN'S INTERNATIONAL CLASS ACTIONS CONFERENCE 2007

1. Overcoming Maintenance and Champerty

Litigation funding in Australia (other than by solicitors providing legal services on a “no win, no fee” pricing policy) emanated from the insolvency market and was enabled by the Corporations Act and Bankruptcy Act providing external controllers and trustees in bankruptcy with statutory powers of sale. Since the commencement of insolvency regimes in Australia, insolvency practitioners have exercised their statutory powers of sale to sell a portion of the fruits of their actions in return for funding to conduct the litigation (the “Insolvency Market”). This was seen as an exception to the rules against maintenance and champerty as the Courts would not prohibit that which the legislature permitted.

Accordingly, from 1997 to 2001, IMF’s business and the business of its predecessor was limited to funding insolvency practitioners.

In 2001, IMF listed on the Australian Stock Exchange and broadened its funding to also include class actions.

This decision was based upon a belief that considerations of public policy that once found maintenance and champerty repugnant would focus more in the future on the social utility of litigation funding.

After addressing the infinitely more liberal attitude towards litigation funding shown by the Courts over the last 20 years, the President of the NSW Court of Appeal in *Fostif Pty Ltd v Campbells Cash and Carry Pty Ltd* [2005] NSWCA 83 at paragraph 100 said:

“These changes in attitude to funders have been influenced by concerns about access to justice and heightened awareness of the cost of litigation. Governments have promoted the legislative changes in response to spiralling costs of legal aid. Courts have recognised these trends and the matters driving them. “Ambulance chasing” still has negative connotations in many quarters, but it is now widely recognised that there are some types of claim that will simply never get off the ground unless traditional attitudes are modified. These include cases involving complex scientific and legal issues. The largely factual account in the book and film “A Civil Action” has demonstrated the social utility of funded proceedings, the financial risks assumed by funders, and the potential conflicts of interest as between group members in mass tort claims propounding difficult actions against deep-pocketed and determined defendants.”

The subsequent decision of the High Court in *Fostif (Campbells Cash and Carry v Fostif)* [2006] HCA 41), which was relevantly consistent with the decision of the NSW Court of Appeal, found:

- (a) there to be no public policy against litigation funding; and

- (b) the funder's control of the proceeding not to be an abuse of process.

The three main effects of Fostif will be:

- (a) cases funded by third party funders will not be delayed by interlocutory disputes over whether there is an abuse of process;
- (b) funders involvement in cases they fund will increase; and
- (c) more capital will be directed to the market and more funders will appear, so the funding market is likely to grow, with more cases likely to be funded.

Currently, there are about four or five other litigation funders in Australia providing funding broadly on the basis that the funder agrees to pay the legal costs associated with the claim and agrees to pay the defendant's costs in the event the claim fails in return for a share of the proceeds of any settlement or judgment, if any.

2. Policy and Practice Concerning Class Actions in Australia

2.1. The Importance of Encouraging Self Regulation

Compensatory enforcement of statutory market protections cannot be left to regulators alone as regulatory budgets are limited and regulators have diverse policy considerations that cause the limited actions that are taken to be in respect of a small proportion of the breaches in our markets.

Moreover, any actions that are taken by regulators are not focused on compensating investors, but on "civil penalties" (where fines are paid to the Treasury).

Consumers, shareholders and lenders who are active in the markets are more capable than regulators of determining which breaches of the market protection laws are significant. Commenting on the identification of cartel offences in the United States, William E Kovacic, general counsel of the Federal Trade Commission, said:

*"Private participation in monitoring the behavior of actors subject to the law can provide more effective detection of violations when the private monitor is closer than a public inspector to the relevant information."*¹

Regulators in Australia have also recognised the utility of private investors seeking to enforce the corporate and trade practices laws.

This recognition is based on the premise that a positive public good is achieved when a private litigant enforces a publicly endorsed standard contained in a statute. Moreover, there is no evidence to suggest the public good is harmed when a private action is unsuccessful, because it is that person, or their funder, who bears the costs of the unsuccessful litigation, not the public regulators.

The chairman of the Australian Competition and Consumer Commission, Graeme Samuel, said in 2005:

¹ Kovacic W, "Private Participation in the Enforcement of Public Competition Laws", speech to Third Annual Conference on International and Comparative Competition Law: The Transatlantic Antitrust Dialogue, May 2003.

*“There seems to be a growing recognition by victims of cartels that they are entitled to seek redress. This coincides with an increased interest from private legal firms (and litigation funders) to pursue such private claims. Compensating victims in private damages actions has been the norm in North America for some time. My expectation is that compensation is set to become more common in Australia too, and this will surely act as a further deterrent.”*²

Finkelstein J in *P Davison Nominees Pty Ltd v Multiplex Ltd* [2007] FCA 1061 noted the role of representative proceedings in acting as a deterrent when contemplating the circumstance of the representative proceeding ceasing and each group member being left to assert his rights alone and said:

*“Most will be forced to give up. That result is unfair for two reasons. It is unfair for those group members who will not be able to pursue any claim at all. It is also unfair because it would undermine the deterrent effect of the existence of sanctions for contraventions of the law regulating securities.”*³

2.2. Practical Considerations

The Federal legislature recognised, when introducing Part IVA of the *Federal Court of Australia Act 1976*, that when many people had sustained small losses which were not economic to recover, a class action device would provide access to the Courts. These claims were envisaged to be predominantly consumer claims relying on statutory market protection standards of conduct, particularly in respect of competition, product liability and the equity and debt markets (“Consumer Claims”). It also recognised that even when claims were large enough to pursue individually, the class action regime would allow groups of persons to pursue their claims more cheaply and efficiently.⁴

But as noted in a recent paper by Vince Morabito, “Australia’s class action regimes have not fulfilled their full potential”.⁵

Grave and Adams, in their recent text book on class actions, say the introduction of class actions in Australia “has not resulted in the opening of the litigation floodgates. Indeed, there has barely been a ripple. The number of proceedings instituted has been small indeed”.⁶

In December 2005, Chief Justice Black of the Federal Court of Australia confirmed that there had been only 158 class actions commenced and finalised in the Federal Court since Part IVA came into operation in March 1992.⁷ Moreover, in the last ten years there have been just nine shareholder class actions.⁸

² Samuel G, “The enforcement priorities of the ACCC”, speech to Competition Law Conference, 12th November 2005 at page 26.

³ At paragraph 54.

⁴ See Michael Duffy (Attorney-General), Commonwealth Parliamentary Debates, House of Representatives, 14 November 1991 at 3174.

⁵ Morabito V, “Corporate accountability, third parties and class actions”, paper for the Company directors and corporate social responsibility seminar, 20 September 2006.

⁶ Grave D and Adams K, *Class Actions in Australia* (Lawbook Co, 2005) p26-28.

⁷ See Drummond M, “ASIC talks up class actions”, *Australian Financial Review*, 5 December 2005 at p5.

⁸ See Murphy B and Watson A, “Shareholder class actions and the duties and discretions of superannuation trustees”, paper presented at the 5th ACSI conference, June 2006.

Morabito says that no Part 4A proceedings have been filed since 15 December 2005.⁹

The main reason that people have not utilised the class action mechanism is not reflective of a lack of viable causes of action but rather the cost of bringing these actions and the Litigation Risks referred to in section 3 below.

The representative party is exposed to the risk of an order to pay the costs of the other side but receives no personal benefit from taking on the representative role. Unless the representative's potential cost exposure is covered by a third party – such as a litigation funder – there is a disincentive to take on the role of representative plaintiff.¹⁰

Excessive costs and delays are prevalent in class action litigation and the principal factor in limiting class actions fulfilling their role as a deterrent to breaches of the market protection regimes.¹¹

2.3. Market Protections Need to be Enforceable

Unless the law can actually protect, and ultimately provide compensation to, victims of illegal conduct, the market protection regime risks becoming illusory or worse, an irrelevancy.

If the laws are not enforceable, then one of the main tools for preventing market misbehavior is severely restricted.

Very few cases alleging breaches of continuous disclosure have been brought, either by the corporate regulator or by investors.¹²

The dearth of private actions is *not* illustrative of few companies acting in breach of the market protection regulations, but rather due to the access to justice barriers inherent in the class action regime and more broadly in the civil justice system.

⁹ Morabito V, "Empirical Study of Victoria's class action regime preliminary findings", unpublished paper, 2007.

¹⁰ See Wilcox J in *Woodlands v Permanent Trustee Co Ltd* (1995) 58 FCR 139 at 145.

¹¹ In many cases, class action proceedings become the subject of extensive interlocutory arguments. Refer to Finkelstein's observations in *Bright v Femcare* (2002) 195 ALR 574 [160].

¹² There are only three Court decisions on continuous disclosure of any substance. *Australian Securities and Investments Commission v Southcorp Ltd (No 2)* [2003] FCA 1369 and *Australian Securities and Investments Commission, in the matter of Chemeq Limited v Chemeq Limited* [2006] FCA 936 were actions brought by the Australian Securities and Investments Commission; *Kim Riley in his capacity as trustee of the KER Trust v Jubilee Mines* [2006] WASC 199 was brought by a shareholder (who successfully recovered damages).

3. The Need For Litigation Funding

People determining whether to commence class actions in Australia are usually confronted with the same risks Lord Woolf identified in 1996 when he examined the English and Wales civil justice system and remarked:

“The defects I identified in our present system were that it is too expensive and that the costs often exceed the value of the claim; too slow in bringing cases to a conclusion and too unequal; there is a lack of equity between the powerful, wealthy litigant and the under-resourced litigant. It is too uncertain: the difficulty of forecasting what litigation will cost and how long it will last induces the fear of the unknown; and it is incomprehensible to many litigants. Above all it is too fragmented in the way it is organised since there is no one with clear overall responsibility for the administration of civil justice; and too adversarial as cases are run by the parties, not by the courts and the rules of the court, all too often, are ignored by the parties and not enforced by the court.” (Law Commission of the United Kingdom, Civil Justice (July 1996): see www.dca.gov.uk/civil/final.)

These risks for potential claimants (the “Litigation Risks”) may be listed as follows:

- (a) not being able to obtain a budget from their solicitor, let alone a set fee;
- (b) not being able to predict how long the litigation process will take with any degree of certainty;
- (c) a pricing policy by the lawyers requiring payment by reference to hourly rates;
- (d) the legal costs of conducting the case blowing out (in some cases to exceed the claim size);
- (e) confronting:
 - (i) well resourced and determined defendants with the capacity to obtain the best legal and expert advice; and
 - (ii) legal advice that they may find difficult to understand or which does not properly identify the risks, including that the claim may fail, with the result that the claimant will not receive any money by way of judgment, will not receive reimbursement of the legal costs paid and will have to pay the other parties’ costs; and
- (f) no capacity to predict how much the potential adverse costs order may be in dollar terms.

As a result of potential claimants’ justifiable concerns about the Litigation Risks:

- (a) speculative actions are minimised (a positive result) but meritorious actions may not be pursued; and
- (b) demand for litigation funding is high and will remain high until the Litigation Risks are better managed by the legislature, the Courts and the legal profession.

4. Funding Reform Mechanisms

4.1. Capital Market Funding

Unlike in the United States of America (the “USA”), lawyers acting for plaintiffs on a speculative basis in Australia, other than in respect of personal injury claims, are few and far between. This difference occurs for two fundamental reasons:

- (a) a prohibition on the charging of contingency fees; and
- (b) cost orders are payable by the losing party.

In 2004, Bernard Murphy, partner at Maurice Blackburn Cashman, in a paper entitled “Practical Difficulties for Applicants in Class Actions”, said:

“There are only two firms of solicitors in Australia who are either large enough, courageous enough or perhaps silly enough to regularly act for applicants in large class actions on a contingency basis. As the partner in charge of the largest class action practice in Australia, I can tell you that it is a difficult area in which to profitably practice. Whilst the media tends to focus on the sometimes large costs orders obtained at the end of a class action, there is a massive expenditure on barristers, experts and solicitor time involved and these are carried for four to five years before payment. If the case is unsuccessful, that expenditure is lost. As a result, few firms are prepared to practice in this area.”

In my opinion the two firms to which Mr Murphy refers have insufficient working capital to mount class actions, are not rewarded sufficiently for the risks they undertake and are unable to adequately address the adverse cost order risks of their clients.

As a result, class actions in Australia have been few and far between. Litigation funders offering to underwrite the class actions in return for a contingency fee, however, are entering the market. Although the annual capital being invested in class actions currently would be less than \$20m per annum, this is likely to double and treble over the next few years.

4.2. Excluding Free Riders

Litigation funders enable representatives to assume the Litigation Risks principally by agreeing to pay the costs and disbursements in respect of the litigation and any adverse costs that may become payable should the litigation be unsuccessful.¹³

However, in order for funding to be made available on an equitable basis, the funder’s outlays and fees must be spread across all members of the represented group. Accordingly, funding is likely to be made available only when each person seeking to litigate has agreed contractually with the funder to pay the costs of the funding (including the funder’s fees) from sums recovered. This highlights the free rider issue which, if left unaddressed, will diminish the willingness of class members to agree to share in the costs of the proceeding and limit the capital available to fund litigation.

¹³ The UK Civil Justice Council in its July paper; “Improved Access to Justice – Funding Options and Proportionate Costs – The Future of Funding of Litigation – Alternate Funding Structures”, stated (at page 70), “*funding was the greatest barrier to bringing legitimate multi-party consumer redress claims*”.

Section 33C of both the Victorian and Federal class action regimes provide that a proceeding may be brought on behalf of “some or all” of the claimants. As noted by Morabito, this demonstrates that:

*“...there is no requirement to the effect that a class proceeding needs to be brought on behalf of each and every person whose claim satisfies the three commencement prerequisites. On the contrary, we have an express legislative conferral, upon class representatives, of the discretion to exclude from the ambit of class proceedings some of the potential claimants.”*¹⁴

Despite this provision, Stone J of the Federal Court has found that:

*“...the requirement that group members opt in to the proceeding to be inconsistent with the terms and policies of Part IVA.”*¹⁵

The practical effect of this decision was that litigation funders would be unlikely to provide funding for proceedings brought under Part IVA of the *Federal Court of Australia Act* (or Part 4A of the *Victorian Supreme Court Act*).

Morabito notes it is “troubling” that the drafters of the Federal Court Act failed “to provide aspiring class representatives with the financial tools required to meet the significant costs entailed in instituting and running a class proceeding that is governed by an opt out device”.¹⁶ He says prohibiting the proceedings from being brought on behalf of some persons (those that wish to have the claims pursued on their behalf) would “constitute a myopic approach as it would entail dealing with the symptom rather than the cause of the problem”. He concludes that the rejection of a mechanism that restricts the class to persons who wish to have claims pursued on their behalf “on the basis that it prevents a significant proportion of claimants from gaining access to justice, represents a self-defeating exercise if it results in access to justice becoming an unattainable goal for all claimants”.¹⁷

It ought to be made clear that the statutory class action procedure is able to be utilised by a group or groups of individuals who are aggregated together, including where such individuals or entities consent to the pursuit of proceedings on their behalf.

This legislative reform currently remains necessary despite the decision of Finkelstein J in *P Dawson Nominees Pty Ltd v Multiplex Ltd* [2007] FCA 1061. In that decision Finkelstein J said:

“... the only persons excluded from the group are free riders, that is persons who make no direct or indirect contribution towards the costs of the action. In my opinion this is not inconsistent with Part IVA... a group that excludes free riders cannot be criticised. On the contrary, there are economically rational reasons to establish such a group. The most obvious is that it provides each potential group member with an incentive to agree to contribute. It also keeps the cost or the burden of purchasing the costs down for each individual. There are other advantages in keeping group members down. For one thing, it is probably easier to settle a smaller claim. For another, there is a greater prospect of obtaining a higher percentage of the amount

¹⁴ Morabito V, “Class Actions Instituted only for the Benefit of the Clients of the Class Representative’s Solicitors”, 29 *Sydney Law Review* 5 (2007) at 13.

¹⁵ *Dorajay Pty Ltd v Aristocrat Leisure Limited* [2005] FCA 1483 at par 125.

¹⁶ *Ibid* n 52 at 38.

¹⁷ *Ibid* at 40.

*claimed by way of compromise. Even respondents may benefit from the prospect of a smaller payout. Indeed, it is odd to hear a complaint from a defendant that there are too few plaintiffs.”*¹⁸

A clearly expressed amendment to the Part IVA regime entitling representatives to exclude free riders and only include people willing to share the cost of the proceedings in the class ought to be considered.¹⁹

This would be a partial step in making representative proceedings fulfil their objectives, including providing a remedy in favour of persons who may not have the funds to bring a separate action or who may not bring an action because the cost of litigation is disproportionate to the value of the claim.²⁰

The complete step in making representative actions inclusive and commercially viable is addressed in section 4.3 “Enabling *Cy-Pres* Orders” below.

4.3. Enabling Class Action Reimbursement of All Representative’s Expenses

Adverse cost orders should not be removed as a method of addressing access issues or Litigation Risks.

The risk of adverse cost orders creates discipline in choosing whether to commence proceedings and justly allocates the cost of incorrect decisions to the unsuccessful party.

Representatives do, however, have a legitimate right to have class members who share in the benefit created by the representative proceeding to share the burden of the cost of the litigation (including all outlays for legal and financial services).

Otherwise, representative proceedings will be limited to circumstances where:

- (a) lawyers charge on a speculative basis (which has shown to be uncommercial as hourly rates do not adequately reward lawyers for the cost of not being paid on unsuccessful claims);²¹
- (b) representatives are prepared to risk adverse costs orders without financial support, which invariably leaves successful defendants with cost orders are not met; and
- (c) they are for identifiable class members who have agreed to share all of the legal and financial costs of the proceedings from any settlement or judgment proceeds.

This later circumstance is the status quo, which is less than optimum as it:

- (a) is an exclusive rather than inclusive process;

¹⁸ At paragraph 48.

¹⁹ This would create certainty, with the *Multiplex* decision likely to be the subject of appeal either in the *Multiplex* proceedings or taken on appeal in unrelated proceedings.

²⁰ Refer to paragraph 22 in the *Multiplex* decision.

²¹ Only a handful of law firms in Australia have the financial capacity and willingness to conduct class actions on a speculative basis, which has led to the amount of representative proceedings in the past being limited by reference to those law firms’ balance sheets, rather than the value of the claims.

- (b) only achieves access for potential class members that become aware of the opportunity (usually the potential members with the larger claims); and
- (c) will not be able, on a commercial basis, to facilitate representative proceedings for small claims where the cost of creating awareness, facilitating enrolment and prosecuting the claims is commercially prohibitive.

In a recent article, Vince Morabito notes it is “troubling” that the drafters of the *Federal Court of Australia Act* failed “to provide aspiring class representatives with the financial tools required to meet the significant costs entailed in instituting and running a class proceeding that is governed by an opt out device”.²²

Finkelstein J, in the *Multiplex* decision, after referring to the Attorney-General’s two purposes for class actions (namely (1) to allow small individually uneconomic claims to be brought; and (2) to allow large claims to be handled with greater efficiency) went on to say:

*“The Attorney-General did not say how those objectives would be achieved through the medium of class action. He did not mean they would happen by some kind of magic. He certainly did not mean that a class action was a simpler and cheaper procedure than an action brought by a single plaintiff seeking to vindicate his individual rights. What the Attorney-General had in mind, and what the class action procedure around the world is designed to achieve, is that group members will continue to share the costs of the action.”*²³

Finkelstein J then goes on, in paragraphs 37 and 38, to list three cost sharing arrangements available, being group members putting up their own cash, speculative fee arrangements with lawyers and purchasing the funding needed to bring the action.

It is appropriate that prospective representatives be able to approach the Court at the commencement of the proceedings, disclose the arrangements in respect of the legal and financial services proposed to be obtained to conduct the proceedings and seek orders that the cost of these services be paid by all class members proportionately from settlement or judgment proceeds (on the basis that any member can opt out for whatever reason).

This reform would:

- (a) facilitate inclusive access to justice, making commercially viable small claims that would otherwise waste;
- (b) restrict unjust enrichment by suppliers contravening the market protection regimes;
- (c) facilitate compensation for aggrieved consumers; and
- (d) follow the lead provided by Canada without the excesses inherent in the system in the USA.

²² Morabito V, “Class Actions Instituted only for the Benefit of the Clients of the Class Representative’s Solicitors”, 29 *Sydney Law Review* 5 (2007) at 38.

²³ *P Dawson Nominees Pty Ltd v Multiplex Ltd* [2007] FCA 1061 at paragraph 36.

4.4. Enabling *Cy-Pres* Orders

Federal Parliament ought to consider the introduction of a new judicial power (or the Judiciary may consider clarification of existing powers) to order *cy-pres* type remedies (i.e. an order that the respondent pay a lump sum calculated by reference to the benefit obtained by the respondent resulting from the contravention) in class action proceedings where:

- (a) there has been a proven contravention of the law;
- (b) a financial or other pecuniary advantage ('unjust enrichment') has accrued to the person or entity contravening the law as a result of such contravention;
- (c) a loss suffered by others is able to be quantified; and
- (d) it is not possible, practicable or cost effective to identify and compensate some or all of those who have suffered the loss.

Enabling Courts to make *cy-pres* orders in these circumstances will make consumer protection laws more enforceable.

Parliaments pass consumer protection laws (e.g. the continuous disclosure provisions in the *Corporations Act* and the anti-competition provisions in the *Trade Practices Act*) to protect markets. However, if the laws are practically unenforceable due to the Litigation Risks, the protections do not serve their purpose.

Representative proceedings could be made to serve their purpose, as consumer protection laws could be made to serve their purpose, by enabling the Court to order the creation of a *cy-pres* fund from which compensation could be distributed by Court order, outside the adversarial process.

Maurice Blackburn has noted that "*This reform would reduce the cost and complexity of representative proceedings litigation, result in the modernisation and simplification of the rules in civil procedure, and promote fairness and access to justice*".²⁴

It is also the inevitable route down which the Courts will proceed for small claims if the concept of proportionality is to be embraced. Otherwise, small consumer claims will waste, leaving defendants unjustly enriched and the consumer protection regimes failing to fulfil their policy objectives.

4.5. Enabling Contingency Fees

The UK Civil Justice Council ("CJC") in a July 2007 paper²⁵ addressed contingency fees in consumer redress cases²⁶ and more broadly.²⁷

The CJC recommended that:

²⁴ Refer to paragraphs 43-71 in the submission by Maurice Blackburn Cashman Pty Ltd to the Victorian Law Reform Commission Civil Justice Review.

²⁵ "Improved Access to Justice – Funding Options and Proportionate Costs – The Future Funding of Litigation – Alternative Funding Structures – A Series of Recommendations to the Lord Chancellor to Improve Access to Justice through the Development of Improved Funding Structures".

²⁶ At pages 68 to 71.

²⁷ At page 71 and 73.

- (a) *“In multi party cases where no other form of funding is available, regulated contingency fees should be permitted to provide access to justice.”*²⁸; and
- (b) *“It is prudent for Government to commence examination of alternative methods of funding in case the sustainability of the CFA/ATE market comes under threat.”*²⁹

Regulated legal firm contingency fees in consumer redress cases should be permitted, provided the representative remains, and the lawyers become, liable for adverse costs. To introduce contingency fees without adverse cost exposure for lawyers would:

- (a) introduce the worst aspects of the civil justice system in the United States; and
- (b) create an unequal playing field with third party funders, who acknowledge that with the right to charge a percentage comes an obligation to pay the defendants’ reasonable costs if the claim is unsuccessful.

5. General Civil Justice Reform Agenda

5.1. Accountability of Funders & Insurers

Insurers when managing claims by indemnified, defendant insureds are also in the business of providing litigation funding. Insurers, like funders, determine which claims are prosecuted and defended, choose the lawyers, instruct the lawyers and pay them and indemnify the insured in respect of adverse cost orders. None of these activities are currently regulated, leaving insurers, like funders, currently unaccountable for these activities.

After reciting that the overriding purpose of the Civil Procedure Act 2005 (NSW) is to facilitate the just, quick and cheap resolution of the real issues in proceedings (sub section 56(1)), the Act:

1. obliges the Court to seek to give effect to that overriding purpose when it exercises power or interprets any provision of the Act or Rules (sec 56(2));
2. obliges the parties to civil procedures to assist the Court to further that overriding purpose (sec 56(3)); and
3. prohibits lawyers from causing their clients to breach their duty to the Court (sec 56(4)).

To achieve the specified overriding purpose it will be necessary to overcome shortcomings similar to those identified by Lord Woolf in section 3 earlier.

Litigation funders, including insurers, have a greater capacity than most to systematically assist or retard the Court in achieving the overriding purpose.

With these concerns in mind, it seems appropriate to:

²⁸ At page 70.

²⁹ At page 71.

1. require parties to inform the Court, at the commencement of proceedings, if the conduct of their case is to be funded in whole or in part by a third party and, if so, to identify that party; and
2. change sub section 56(3) of the Civil Procedure Act so that it reads:

“A party and any person paying any part of the legal costs of a party to civil proceedings is under a duty to assist the court to further the overriding purpose...”

The Federal Court of Australia is looking at including in its Court Rules a provision similar to the first of these proposals.³⁰

Further, there is no specific public data available concerning funders or insurer’s claims management expenditure in our civil justice system. Given the utilisation by funders and insurers of our subsidised system, our legislature and Courts should consider collecting relevant data to ensure the funder/insurer interface with our civil justice system is understood and appropriately regulated. This data could include:

- (a) the number, type and value of claims funded by each funder and the number, type and value of defended claims funded by each insurer;
- (b) the cost of the litigation to the funders, insurers and the Courts;
- (c) the levels at which the parties were prepared to settle the case; and
- (d) the value of settlements or judgments and the time each proceedings took to resolve.

This data could provide some surprising statistics. For example, it is acknowledged by the insurance industry that about 75 cents in every dollar paid out by insurers on directors and officers policies goes in defending the claims, with only 25 cents going to the claimants. This type of statistical data was powerfully used in the recent tort reform debate and must be relevant in any litigation funding debate.

Making funders, including insurers, accountable for their involvement in the Court process in the same way as the parties themselves, seems an obvious means of better protecting and promoting the interests of the Courts as well as the interests of the consumers of the Courts’ services.

5.2. Disclosure and Cooperation Pre Litigation

IMF commends to the Commission the Canadian Civil Justice Reform Working Group’s report titled *Effective and Affordable Civil Justice* which set out a model for a Case Planning Conference for close examination by the Civil Justice Council when created.³¹

Early and effective disclosure of information relevant to the Litigation Risks³² will lead to early settlement or a sound foundation for the efficient management of proceedings where litigation cannot be avoided.³³

³⁰ One hopes that the obligation to inform the Court will be on insurers as well as funders as the relevant committee looking at the relevant changes to the Rules is the “Litigation Funding and Insurance Funding Committee”.

³¹ Refer to IMF’s April Submissions at pages 21 and 22.

³² The Litigation Risks include are listed in section 3.

³³ Refer to the *Department for Constitutional Affairs, Civil Procedure Rules, Practice Direction – Protocols* at paragraph 1.4).

A Pre Litigation Conference (“PLC”) would further advance the likelihood of the Overriding Purpose being achieved, including:

- (a) *Pre-Litigation Budgets and Timelines*: Detailed legal budgets and timelines should be produced by all parties, at least in Supreme and Federal Court matters. Those budgets can then be discussed and amended to reflect the project design determined at the PLC. (Budgets are discussed in more detail in section 5.4(a) below;
- (b) *Limiting interlocutory disputes*: In any PLC, the judge could ensure that any proposed interlocutory hearings are relevant to the issues as defined in that meeting and that the preparation of the case is focused on evidence that will assist the Court in its determination of the real issues as defined in the meeting;
- (c) *Costs orders*: Adverse costs should be limited to the budget so long as there is no change to the design of the project (this is discussed further in sections 5.4(b) below); and
- (d) *Mandatory PLC offers*: Mandatory offers could be exchanged at the PLC and disclosed to the Court if the matter runs to judgment to be taken into account on the question of costs.

5.3. Costs

(a) **Compulsory Provision of Litigation Budgets and Timelines**

Disclosure by lawyers to the client about liability and quantum alone is not sufficient. Budgets and timelines for any litigation should be provided to each party, the Court and the opposing party at or shortly after the initial Pre Litigation Conference. Without this disclosure, it is hard to envisage plaintiffs are agreeing to the commitments involved in civil litigation on an informed basis. While each side’s estimate of what is “reasonable” is likely to differ, the Court must attempt to cap the budget at a reasonable level at or near the commencement of the proceedings, with recoverable costs to be fixed at this level (see section 5.4(b)). Both parties would be free to spend more, but should not expect the other side to pay an adverse costs order in excess of the cap.

The provision of non binding cost estimates do not assist clients who use the Courts rarely and seek to determine whether the expected expenditure is *commercially viable* given the nature of the claim and the quantum of damages being sought.

Moreover, in a system where the loser pays the other side’s costs, probably the biggest risk in embarking on litigation is assuming the risk of paying the other side’s costs if the claim is unsuccessful. As Zuckerman has observed, “*A litigant’s worst nightmare is that he will have to pay the other party’s costs as well as his own.*”³⁴

It is critical to the success of any civil justice reform to make costs and the time involved in the process more predictable at the outset of the process.

³⁴ Zuckerman A, “Cost capping orders in CFA cases improve costs control but raise questions about the CFA legislation and its compatibility with Art 6 of the European Convention on Human Rights”, *Civil Justice Quarterly*, 2005.

As noted by Peysner (referring to developments in the UK):

“The traditional response is to compare litigation to war: bloody and expensive but above all unpredictable. More recently under the influence of the CPR and case management it has become clear that litigation can be more prospectively managed and, indeed many clients demand that their own side’s strategy and costs are extensively planned so that both their solicitor’s final bill and their demands for interim payments are predicable.”³⁵

The formulation of budgets must be sufficiently flexible to recognise that litigation is inherently uncertain and that there will be issues that arise during a project that cannot be foreseen, or foreseeable, at the outset of the project. Nevertheless, the vast majority of costs can be estimated in advance, as much of the work – taking statements, drafting affidavits, preparing for trial – is common to all cases, even though some cases are more complicated than others.

This increased transparency regarding expected costs would benefit the Courts, the parties and the parties’ lawyers.

The Courts

Provision of budgets will allow the Courts to:

- (i) monitor excessive costing and determine that anticipated expenditure is proportional;
- (ii) monitor excessive timelines to ensure that cases are brought on expeditiously without unnecessary delay;
- (iii) better facilitate case management by allowing proceedings to be monitored by reference to timelines and expected expenditure;
- (iv) allow the Court to refer to budgets rather than time costing when reviewing lawyers’ claims for solicitor/client costs; and
- (v) quantify party/party adverse cost orders more efficiently than through taxation or assessment.

The Court’s oversight of budgets is vital and the parties should be encouraged not to spend more than is proportional to the nature of the dispute. By monitoring budgets, the Court will act to motivate the parties to achieve the Overriding Purpose and demotivate delay and expense.

The Parties

The provision of budgets will also assist the parties to determine the likely expenditure at each critical stage of the litigation, thereby enabling cash flow management. It also allows for quantification of their exposure to adverse costs in advance of the project commencing.

³⁵ Peysner J, “Predictability and Budgeting”, *Civil Justice Quarterly* 23(Jan) 2004 15.

This submission argues that adverse cost orders should be capped at a level set at the Pre Litigation Conference by the Court having regard to the budgets of the parties, their respective openly stated valuations of the claim and the Overriding Purpose, rather than being assessed on the basis of time costing.

Certainty about expenditure and likely adverse costs would allow for an informed decision as to whether to proceed with the litigation if settlement prior to litigation cannot be achieved. This compares favorably to the current situation where the uncertainty concerning predicting adverse costs is a material barrier to entry to the System.

The Lawyers

This proposed disclosure will also benefit the legal representatives of the parties in that they will be better able to seek to deliver resolution of the claims in accordance with their client's expectations concerning cost and time.

It is also important that the client and the lawyer are on the same page with respect to budgets. The *quid pro quo* of being provided with an affordable budget is the recognition by a client that it will not sue the lawyer in negligence for failure to investigate every possible legal remedy. It is the trade off for obtaining a just, quick and cheap resolution of the real issues in dispute.

(b) Fixed Recoverable Costs

It is not only the quantum of costs that concerns consumers of the System but the unpredictability of those costs. The lack of any objective criteria concerning the level of costs that should be reasonable given a case of a particular complexity makes assessment of costs even more difficult, especially to someone with little experience of litigation.

While fears of adverse costs acts as a deterrent to bringing an action, once it becomes clear that an action will go all the way to trial, the indemnity principle erodes sensitivity to increased costs because litigants know that success will result in the recovery of costs paid and increased spending may increase the chances of success. The other party will typically respond and also increase their stakes, and the costs snowball, thereby increasing risks to all parties.

Bret Walker SC, in his article "Proportionality and Cost-shifting", argues that central to his proposal to assess the amount a loser has to pay a winning party in litigation "*is to transform the qualitative and rhetorical nature of 'proportionality' into an overtly precise matter of measurable sums of money*" and the "*object of the exercise is to permit ascertainment sooner rather than later of the amount of costs the loser will have to pay the winner*".³⁶ Mr Walker continues:

"This should enhance decision-making, whether to fight or settle. It is also intended to deprive a deep-pockets litigant of some of the advantage money can buy, by denying the possibility of manoeuvres, complexity and elaboration initiated or provoked by that richer party augmenting the costs payable to that party even if it wins. It ought to tend against the currently perverse incentive

³⁶ Walker B, "Proportionality and cost shifting", 27(1) *UNSW Law Journal* 214 at 217.

by which time-based charges by lawyers reward slowness. It is also hoped that such an approach would reduce the transaction costs as between parties and their own lawyers, by eliminating to a large degree the need for detailed bills of costs to be prepared for presentation to the losing party for payment to the winner. Finally, it may be that, if the figures are appropriate and market conditions permit, the idea would provide a moderate downwards pressure on the charge-out rates for relatively straight-forward litigation work. Above all, the aspects of the proposal which may conduce to some or all of these happy outcomes should also involve a general disincentive on both sides to complicate the litigation more than a case really requires.”³⁷

Mr Walker notes that his proposed approach “owes a deal to some German procedures, but is by no means closely modelled upon them”. Nevertheless, it is worth examining the scheme that has been adopted in Germany and another adopted by New Zealand to make costs more predictable.

In Germany, as in Australia, a successful litigant is normally entitled to recover the litigation costs from the unsuccessful opponent.

But unlike Australia, the law in Germany known as the RVG regulates the amount of recoverable costs.³⁸

Under the RVG, recoverable lawyers’ fees are fixed by law as a small percentage of the value of the claim, which declines as the value of the claim increases. The fee for a claim of £100,000 would be in the region of £5,000. Cannon says that parties are reluctant to pay in legal fees more than they can expect to recover from the other side.³⁹

There are a number of benefits of the German system, as noted by Zuckerman:

“The German system has several advantages. First, it removes the incentive to exaggerate the value of claims, because the Court fee and the lawyer’s fee are related to the value of the claim and because recovery of costs is in proportion to the sum awarded. Secondly, litigation costs are moderate, and far lower than in England. Thirdly, since litigation costs are predictable there is a thriving market for litigation cost insurance. Most household insurance policies provide cover for litigation costs, so relatively few citizens feel shut out of Court.”⁴⁰

The costs discretion in New Zealand provides a formulaic approach, allowing clients to be informed in advance of what the likely costs – of success or failure – will be. The Rules⁴¹ ensure that costs are determined by having regard to a proceedings complexity and significance.

³⁷ Ibid.

³⁸ See here, and for more detail on the RVG, Cannon A, “Alternatives to Activity Based Costing”, a paper delivered to the 24th AIJA Conference, Adelaide 16-17 September 2006. The RVG recently replaced a similar basis of costing in the German Civil Code known as the BRAGO.

³⁹ Ibid.

⁴⁰ Zuckerman A, “Court Adjudication of Civil Disputes: A public service that needs to be delivered with proportionate resources within a reasonable time and at reasonable cost”, a paper delivered to the 24th AIJA Conference, Adelaide 16-17 September 2006.

⁴¹ New Zealand High Court Rules, which took effect on 1 January 2000.

As Beck notes, “*Instead of relying almost entirely on a general discretion to achieve appropriate awards, it was seen as important to make costs predictable and relatively simple to determine*”.⁴²

One of the five overriding principles (set out in Rule 47) of the New Zealand regime is the “*determination of costs should be predictable and expeditious*”.⁴³

In summary, the rules limit the recoverable costs which can be awarded to a successful party by conducting a systematic assessment process, whereby the Court classifies proceedings according to their complexity, and the time which ought to be expended on a particular step.

Importantly, the determination does not depend on the actual cost or time involved but rather is an objective approach which seeks to determine the costs that ought to be considered appropriate given a particular proceeding’s level of complexity.

The rules also make specific provision for situations in which increased costs (including indemnity costs) and decreased costs may be awarded and the rules are subject to an overriding discretion of the Court.⁴⁴

Over the last three years, the UK Courts have responded to concerns about cost and delay, in spite of the introduction of the new Civil Procedure Rules, in part by recognising a broad power to impose limits on recoverable costs.

A principal theoretical basis for cost capping is the doctrine of proportionality and the test for whether a cost cap should be imposed is whether there is a real and substantial risk that without a cap, costs could be disproportionate or unreasonably incurred and this risk could not be controlled by case management or post case detailed assessment.⁴⁵

Cost orders should be, *prima-facie*, capped at the cost budgeted at or shortly after the initial Pre Litigation Conference, with increases to the cap only possible where it is shown to the Court that the opposing party extended the project from that which was envisaged in the original budget.

Additionally, where solicitor client costs are in issue, the same cap should be imposed, except where the client declines protection at the Pre Litigation Conference, with an entitlement for the lawyers to seek an increase from the Court on the same basis as in the preceding paragraph.

⁴² Beck A, “The costs discretion”, *New Zealand Law Journal*, November 2001 at 425.

⁴³ A detailed description of the Rules is outside the scope of these submissions but contained in a paper by The Hon Justice Venning titled “Alternatives to Activity Based Costing: the New Zealand Approach”, which was delivered to the 24th AIJA Annual Conference, Adelaide, September 2006.

⁴⁴ That said, the Court of Appeal has found that the discretion should be viewed in the context of specific rules and is not unfettered: *Body Corporate 97010 v Auckland City Council* CA 234/00 (30 August 2001).

⁴⁵ *Smarty v East Cheshire NHS Trust* [2003] EWHC 2806 (QB).

(c) Discouraging Cost and Delay through Cost Orders

In addition to lawyers owing a duty to the Court to assist it in achieving its Overriding Purpose, there needs to be a more vigorous approach from the judiciary towards tactics that deliberately delay the resolution of the real issues and run up costs. This approach by the judiciary is vital to creating the cultural changes necessary in the System in order to achieve access to justice.

The “Overriding Purpose” of the Commercial and Managed Cases List in Western Australia is to “bring cases to the point where they can be resolved by mediation or tried in the quickest, most cost effective way, consistent with the need to provide a just outcome.” The practice direction requires judges overseeing the new list to discourage interlocutory disputes with all means at the Court's disposal, “including costs orders in appropriate cases”.⁴⁶

Chief Justice Young in the Equity Division of the NSW Supreme Court has said that the Court should only order a legal practitioner to pay the costs of legal proceedings in respect of which he or she provided legal services in clear cases of misconduct and mostly it is difficult to assess whether the solicitor or client was the real cause of the problem. Nevertheless, His Honour noted that:

“If in a future case, the facts clearly showed that a solicitor had given very bad advice to an unsophisticated client who had accepted it without question with the result that the company concerned had incurred substantial legal costs, that may well be a case where the Court would, after giving the solicitor due notice to explain, make an order that the solicitor pay the costs personally.”⁴⁷

More orders to pay costs for cost and time-wasting will change behavior and make significant inroads to eradicating the attitude held by some lawyers that litigation is a game, and tactics which deliberately prolong the proceedings or their cost, or both, are part of the game.

5.4. Proving Causation Other Than By Proving Reliance

It is debatable whether proof of reliance on misleading statements or omissions is necessary in order to prove loss was caused by a market protection breach.

The test for causation under the misleading conduct provisions is whether the representative suffered loss and damage “by” conduct of the company. Accordingly, reliance is clearly not an express requirement of the provisions – it is but one way to prove causation.

There are also obvious logical difficulties in relying on an “omission”. If you are alleging a breach of the continuous disclosure regime, on what did you rely?

Introducing the assumption of reliance when shares are purchased at a time when the company is in breach of its legal obligations is not radical. Inferred reliance has already been recognised in decisions considering the application of the *Trade Practices Act*. For

⁴⁶ Supreme Court of Western Australia, Practice Direction 4 of 2006.

⁴⁷ *Re the Black Stump Enterprises Pty Ltd and Associated Companies (No 2)* [2006] NSWCA 60.

example, where a representation is likely to induce the representee to enter into a contract and the person actually enters the contract, the Court may infer reliance⁴⁸.

Proof of causation may be limited to proving the representative purchased in a market which was inflated as a result of the contravening conduct.

This would remove the need to gather and provide evidence of detrimental reliance by each and every shareholder upon each and every particular representation.

5.5. Statutory Measures For Loss Calculation

Calculation of the direct loss suffered by each shareholder currently requires expert evidence concerning the true value of the shares during the period in issue.

An efficient method of identifying the true value of the shares would be the appointment by the company and the shareholders of one independent expert who could provide a binding expert determination.

Alternatively, the legislature could introduce a formula for measuring loss such as the difference between the purchase price and sale price.

The focus of the legislature must be on creating a compensatory rule that is easily understood and workable. As the High Court has noted, referring to a judgment of Lord Steyn in the House of Lords:

*“The fundamental rule was that the plaintiff should be compensated; that the rule which turns on an assessment of value is only a means of giving effect to the overriding compensatory rule.”*⁴⁹

Where consumer protection laws are found to be breached, proof of reliance should not be an essential element of proving causally connected loss. The costs and delays in having to prove reliance and in quantifying loss for each and every represented person in the Court’s adversarial processes is one of the principle reasons why our laws are not enforced, some may say unenforceable.

John Walker
24 October 2007

⁴⁸ *Gould v Vaggelas* (1985) 157 CLR 215.

⁴⁹ *HTW Valuers (Central Qld) Pty Ltd v Astonland Pty Ltd* [2004] HCA 15 at par 63. The decision of Lord Steyn was in *Smith New Court Securities Ltd v Scrimgeour Vickers (Asset Management) Ltd* [1997] AC 254.