Litigation funding for class actions: help or hindrance?

Advanced Issues in Class Actions
The College of Law – 10 March 2016

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A. What is Litigation Funding?
   - IMF’s process for funding a class action

B. Australian Litigation Funding Market
   - IMF has funded some of Australia’s largest class actions
   - Sources of funding for class actions
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D. “Competing” Class Actions and Common Fund Orders

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WHAT IS LITIGATION FUNDING?

- As a litigation funder IMF provides funding on a contingency basis to businesses and individuals with claims for loss and damage. IMF has funded a number of Australia’s major class actions.

- IMF provides litigation management expertise and funding for the client’s case or to the client and, in jurisdictions where adverse costs are relevant (such as Australia), agrees to pay any costs (incurred during the term of the funding agreement) awarded to the other side should the client’s case be unsuccessful. IMF will also provide any security for costs which may be ordered.

- In return, IMF generally receives a right to be reimbursed all that it has paid out and receives a percentage (typically 20 – 40%) of the amount awarded to the client by way of judgment or settlement.

- As a litigation funder IMF does not provide legal advice and is not paid “on an hourly rate”. Lawyers funded by IMF enter into direct retainers with the funded clients.

- Litigation funding is a private market response to the demand for increased access to justice in times of high, and rising, legal costs, particularly for large and complex litigation such as class actions.
IMF’s PROCESS FOR FUNDING A CLASS ACTION

- Identification of a potential class action
- Due diligence process and investment criteria
- IMF Investment Committee review and decision
- Litigation Funding Agreement and Client Disclosures
- ASX Announcement – funding conditional on sign-up
- Bookbuild
- Commencement of the class action – common issues and representative’s claim litigated
- Mediation or judgment on common issues
- Settlement
- ASX Announcement and reporting

There is currently no direct empirical data available on the size of the litigation funding market in Australia.

The following estimates have been calculated by reference to third party research reports, court statistics or competitor opinion on litigation market size and estimating the fundable portion based on litigation areas in which IMF operates:

Litigation spending is arguably correlated to the economic cycle, and is expected to be soft in the next several years. However, litigation funding is arguably counter-cyclical and demand for funding may exceed growth in the demand for litigation spending.

Penetration rates for litigation funding remain low in Australia even though the litigation funding industry here is the most advanced of any of the major common law jurisdictions.
Shareholder Class Actions:
- Aristocrat, AWB, Centro, Treasury Wine Estates, Oz Minerals.

Claims against Governments:
- Wivenhoe Dam (State of Queensland), Pan Pharmaceuticals (Commonwealth Government).

Claims against the Banks:
- Bank fees class actions.

Claims by non-shareholder investors:
- BrisConnections, RiverCity Motorway, Great Southern (Woodlots, Cattle).

Claims by cartel victims:
- Air Cargo.
There is today a wide range of sources of funding for class actions. Among the litigation funders, the key participants in the Australian market include:

The support provided by funders is in addition to lawyers funding class actions on a “no win no fee” basis, either with or without after-the-event (ATE) insurance to cover adverse costs. Some class actions have been funded by group members themselves, insurers or regulators, such as ASIC.

There are also opportunistic funders who deploy funds from family investments, hedge funds or specialised close ended funds. These funders have also been visible in the class action area.

It is estimated that IMF has 69% of the Australian litigation funding market (ref : IBIS 2014).

<table>
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<tr>
<th>ASX-Listed Funders</th>
<th>Private Australian Funders</th>
<th>Overseas Funders Operating in Australia</th>
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<tr>
<td>IMF Bentham Limited</td>
<td>LCM Litigation Fund Pty Ltd</td>
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<tr>
<td>Hillcrest Litigation Services Limited</td>
<td>Claims Funding Australia</td>
<td>Vannin Capital Limited (UK)</td>
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<td>Litman Holdings Pty Ltd</td>
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<td>Comprehensive Legal Funding LLC (USA)</td>
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<td>Mark Elliott / Melbourne City Investments</td>
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Sources of Funding for Class Actions

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- Omni-Bridgeway (the Netherlands)
IMF’S TRACK RECORD

IMF’s track record to 31 December 2015

Summary

- **180** cases commenced and completed since listing.
- ROI of 144%.
- Average investment period of 2.4 years.
- Generated revenue of $1.67bn:
  - $1,055m to Clients (63%);
  - $613m to IMF comprising:
    - $251m reimbursement of costs (15%); and
    - $362m net revenue to IMF (excluding overheads) (22%);
- Lost cases cost $38m including adverse costs paid and provisions raised.
- Withdrawals cost $5m.
- Losses and withdrawals cost 7% of IMF revenue.
- IMF’s investment portfolio was $3.15bn at 31 December 2015. The Australian component of the portfolio comprised about $2bn.
LITIGATION FUNDING HAS HAD A POSITIVE IMPACT IN FACILITATING CLASS ACTIONS…

- Law Council of Australia and the Federal Court of Australia:

  “In many senses, litigation funding has proven to be the lifeblood of much of Australia’s representative proceeding litigation at federal and state level. Not all cases are funded by third-party litigation funders but a sufficiently large number of class actions have been funded in this manner that it has had a major impact of the sorts of cases being conducted…This is a consequence of the time, cost and complexity of most representative proceedings and the risk burden, carried by the representative applicant, of an adverse costs order.”

- Productivity Commission:

  “In the case of class actions, litigation funders identify, contact and organise members of the class where it might otherwise be unfeasible for a group of plaintiffs to organise themselves. Moreover, they remove the liability for adverse costs orders, which is a particularly pronounced disincentive in bringing class actions because non-representative group members are statutorily immune from costs ordered against the representative party. This means the representative party is normally liable for all adverse costs ordered but is only entitled to a share of the payout.”

...AND THERE HAS BEEN NO ‘AVALANCHE’ OF CLASS ACTIONS

- Litigation funding of class actions has not led to a flood of litigation.
- We know the precise facts due to the empirical research of Professor Vincent Morabito.
- According to his research:
  - In the first 22 years of the Federal Court’s class actions regime (to 3 March 2014), 329 class actions were filed. 180 were filed in the first 11 years, 149 in the second 11 years. 4
  - Only 49 (14.8%) class actions were supported by a commercial litigation funder. 5
  - In the period 2009 – 2014, 31 (39%) class actions were funded. 6
  - In the 17 years from 1992 to 2009, every funded class action in the federal system was resolved in favour of the class and, on average, 29.6% of recoveries went to funders. 7
  - Commercially funded Part IVA actions covered a total of approx. 70,500 claimants. 8

5. Ibid, 3.
8. Idem.
Although litigation funding has facilitated the bringing of class actions, it is criticised for having led to the advent of “closed classes” (i.e. the class action is open only to group members who have signed a funding agreement). This is said to be inconsistent with the “opt out” nature of Part IVA and to have caused an increase in the problem of “competing class actions”.

“Competing” class actions are multiple representative proceedings commenced with respect to (essentially) the same dispute (whether by the same or different legal practitioners). They are, in fact, endemic to Australia’s class action regime, although their incidence is modest in comparison to the situation in the United States and Canada.

“Contrary to popular belief, Fostif and Multiplex have not resulted in the Federal Court of Australia being inundated with numerous competing Part IVA proceedings. Nor have they increased the frequency of competing Part IVA proceedings.”

Nevertheless, the need for a funder to achieve sufficient certainty at an early stage that its investment in a class action will produce an adequate return if the action is successful may, paradoxically, limit access to justice by making open class proceedings unattractive or unviable for funding.

10. V. Morabito, note 7, 3.
“Common funds” have been proposed as a solution to the competing class action problem. Under a common fund order, the Court approves payment of the funder’s percentage share out of the entire fund recovered by the class, irrespective of whether all class members have signed a funding agreement.

Common fund orders are not unusual in North America. The US Supreme Court has explained:

“[this Court] has recognised consistently that a litigant or a lawyer who recovers a common fund for the benefit of persons other than himself or his client is entitled to a reasonable attorney’s fee from the fund as a whole…the [Common Fund] doctrine rests on the perception that persons who obtain the benefit of a lawsuit without contributing to court costs are unjustly enriched at the successful litigant’s expense. Jurisdiction over the fund involved in the litigation allows a court to prevent this inequity by assessing attorney’s fees against the entire fund, thus spreading fees proportionally among those benefited by the suit”.  

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Common fund orders have been made in Australia at the settlement stage in proceedings. However, an attempt to obtain a common fund order at an earlier stage in a Part IVA proceeding was unsuccessful: *Blairgowrie Trading Ltd v. Allco Finance Group Ltd ( Receivers & Managers Appointed) (In Liq)* [2015] FCA 811 (7 August 2015).

In *Allco* the representative’s lawyers sought orders for payment of the funder’s commission (between 32.5% and 35%) from any amounts recovered from the Respondent for the benefit of class members. The application was made following the filing and service of pleadings.

Wigney J declined to make the orders sought, because the proposed orders were “neither appropriate or necessary to ensure justice is done in the proceeding”, were “premature” (particularly as the reasonableness of the amounts could not be assessed at the early stage the proceedings had then reached) and “the only clear beneficiaries of the proposed order” would be the applicants and the funder: [75].

His Honour left open the possibility that a common fund order could be made at some later stage in the proceedings ([222]), or in other Part IVA proceedings, and suggested that legislative reform might be appropriate “to deal with the reality of commercial litigation funding in representative proceedings” ([227]).

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“COMPETING” CLASS ACTIONS AND COMMON FUND ORDERS (Cont’d)

- It appears that Wigney J was confounded by the lack of information before the Court on which to make an order, and the uncertainty around the implications of making (or not making) the order. In particular, his Honour raised questions concerning:
  - the level of the claimants’ losses and the likely amount of any recovery;
  - the size of the class;
  - whether the proceeding is commercially viable, from the perspective of proposed litigation funders;
  - how many class members would have signed funding agreements with the funder if asked;
  - the amounts that may be payable to the funder if the claims are successfully resolved;
  - the likely legal costs the applicants will incur; and
  - the Court’s power to make the orders sought.

- It seems inevitable that further applications will be made in the future and, as other commentators have noted, a common fund order will likely eventually be made. In doing so, will the courts introduce a de facto certification stage into Australia’s class action procedure?
ISSUES ON THE HORIZON: CONTINGENCY FEES & REGULATION OF FUNDERS

Two issues affecting the funding of class actions excite particular controversy:

i. Should lawyers be permitted to charge applicants and class members a contingency fee (i.e. a percentage of any recovery)?

ii. Should litigation funders be regulated?

As to the first, the prohibition on lawyers charging contingency fees created a gap now filled by litigation funders. Contingency fees have been allowed in the US for over 100 years and have recently (though imperfectly) been permitted in the UK. Contingency fees are currently a hot topic in Australia.

As to the second, litigation funders in Australia are subject to light-touch regulation: their funding agreements are required to be disclosed but otherwise, if they maintain adequate practices and procedures for managing conflicts of interest, they are exempt from the licensing regime in Chapter 7 of the Corporations Act 2001 (C’th).

Funders are not required to be registered in Australia, maintain sufficient (or any) assets here, or disclose their financial position or track record (unless they are ASX-listed).

In its 2014 report on Access to Justice Arrangements, the Productivity Commission recommended:

1. That the restrictions on Australian lawyers charging contingency fees should be removed subject to certain consumer protections being put in place (prohibition on such fees in criminal and family matters, comprehensive disclosure obligations, caps on percentages for retail clients and no charging of additional fees).

2. The Australian Government should establish a licence for litigation funding companies designed to ensure they hold adequate capital relative to their financial obligations and properly inform clients of relevant obligations and systems for managing risks and conflicts of interest.

3. Regulation of the ethical conduct of litigation funders should remain a function of the courts.

4. Court rules should be amended to ensure that both:
   (a) the discretionary power to award costs against non-parties in the interests of justice; and
   (b) obligations to disclose funding agreements

   apply equally to lawyers charging contingency fees and to litigation funders.\(^\text{16}\)

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16. Productivity Commission, note 3, recommendations 18.1, 18.2 18.3.
ISSUES ON THE HORIZON: CONTINGENCY FEES & REGULATION OF FUNDERS (Cont’d)

- The heated debate over contingency fees and the regulation of litigation funders continues unabated.

- The legal profession is divided over contingency fees. In a recent submission, the Law Institute of Victoria (LIV) noted the Victorian Bar opposes lifting the prohibition on contingency fees (as they “would likely have perverse and unintended consequences for the civil justice system”) while the LIV “has long advocated for the introduction of contingency fees.” 17

- The Victorian Legal Services Commissioner, Mr Michael McGarvie, has trenchantly criticised any change to the law. 18

- The States are also divided, with Victoria’s Attorney-General indicating support for lifting the ban while New South Wales’ Attorney-General has stated that the issue is “not under active consideration”. 19 Concerns have also been raised over intensified conflicts of interest and agency problems attendant on contingency fees. 20

- In relation to the regulation of litigation funders, the industry awaits the proposed regulations. IMF supports principled and proportionate regulation of the sector. Others have a concern that regulations could become a barrier to entry, restricting competition between funders. That seems unlikely.

20. The litigation funding model has the advantage that the funder, an experienced litigant, supervises the lawyers’ conduct on behalf of the funded claimants: Productivity Commission, note 3, 635.
THE FUTURE OF FUNDING CLASS ACTIONS

- As the late Yogi Berra said, “It’s tough to make predictions, especially about the future”.

- Judging by trends to date, it seems reasonable to prophesy that:
  - class actions will remain an important part of the Australian legal system;
  - it will continue to be necessary to find ways to fund such actions;
  - litigation funding will continue to expand and deepen in Australia, both through the organic growth of existing providers and through new entrants (Australian and foreign) joining the market;
  - litigation funders will be subject to regulation, probably involving licensing and some form of prudential supervision (this will improve capital adequacy, transparency and standards to the benefit of clients, respondents and the courts and will generally strengthen the sector);
  - common fund orders may be permitted and could become routine, improving the viability of “open class” representative proceedings;
  - the Courts will continue to streamline their management of class actions, with greater use of ADR and closer judicial supervision of the conduct of proceedings; and
  - the question will be whether lawyers will be permitted to charge contingency fees (subject to consumer safeguards, including liability for adverse costs and potentially financial regulation).

- The result will be a continued improvement in access to justice with greater security for class action litigants, both applicants and respondents.