

BENTHAM IMF LIMITED

Response to Draft Report of the Productivity Commission: *Access to Justice Arrangements*

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IMF#1562140v3

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1. Bentham IMF Limited (“**IMF**”) commends the Productivity Commission on its comprehensive draft Report on Access to Justice Arrangements and welcomes this opportunity to present further submissions to the Commission in the light of the Commission’s draft recommendations.
2. We have restricted our submissions to the Commission’s proposals in relation to private funding for litigation (set out in Chapter 18 of the draft report), which is the area in which we have the greatest experience and expertise. However, we may comment on other areas of the draft report when appearing before the Commission at the public hearing in Sydney on 3 June 2014. Our representatives will be happy to answer any questions the Commissioners may have, on our submissions or otherwise, at that hearing.

Summary of the Submissions

3. In summary, IMF submits as follows:
 - 3.1. There should be a general ethical obligation on a lawyer to inform his or her client of all options potentially available to the client to fund any litigation the client may wish to undertake.
 - 3.2. IMF accepts that allowing Australian lawyers to charge contingency fees would be likely to improve access to justice in this country and would also increase competition for litigation funding. However, IMF considers that the current model of third party litigation funding, in which the funder operates at arms’ length to the lawyers, is superior to contingency fee charging by lawyers for the reasons set out at [4.68] – [4.72] of IMF’s initial submission to the Productivity Commission.
 - 3.3. If the Commission’s draft recommendation 18.1, that “*Australian governments should remove restrictions on damages-based billing [i.e. contingent fees] subject to comprehensive disclosure requirements*”, is accepted, IMF submits that, in addition, lawyers who wish to act under a damages-based agreement (“**DBA**”) should be subject to appropriate elements of the regulatory regime that applies to litigation funders.
 - 3.4. In particular, lawyers who act under a DBA (“**contingency fee lawyers**”) should have the same potential liability to pay adverse costs if the litigation they act in is lost, as litigation funders face in litigation contingently funded by them.
 - 3.5. While the courts may develop principles that reflect submission 3.4 to guide the exercise of their discretion to make a non-party costs order against a contingency fee lawyer, IMF submits that the courts’ power to make such an order should be set out clearly in court rules or legislation.
 - 3.6. The disclosure requirements for DBAs should include, at a minimum, the matters set out in paragraph 47 of this submission.
 - 3.7. No limit should be imposed on the maximum percentage payable to a lawyer who wishes to act under a DBA. The percentage should be subject to negotiation between the lawyer and his or her (fully-informed) client. Sufficient protections exist under current law to prevent lawyers from entering into or enforcing an unjust, unconscionable or unethical DBA, but the law should mandate a cooling off period for DBAs and a requirement that clients be informed of their right to take independent legal advice on a DBA before signing it.
 - 3.8. IMF agrees with the Commission’s draft recommendation 18.2, that “*third party litigation funding companies should be required to hold a financial services licence, be subject to capital adequacy requirements and be required to meet appropriate ethical and professional standards*” – a position that IMF has long advocated - and submits that lawyers who act under DBAs should be subject to the same requirements *in relation to their funding activities under DBAs only*.
 - 3.9. IMF is willing to work constructively and efficiently with Treasury and ASIC (and any other body the Government may establish for this purpose) to develop the appropriate licence and regulatory requirements applicable to litigation funders (including contingency fee lawyers).

- 3.10. IMF does not favour the development of an industry code of conduct in Australia for litigation funders, as has occurred in the United Kingdom. IMF favours mandatory licensing and regulation of litigation funders, rather than a voluntary code.
- 3.11. IMF notes that the Commission suggests that a Code “*could serve as guidance for the Courts in overseeing the behaviour of litigation funders*”. IMF submits that it would preferable for the courts to develop practice notes, directions or rules, in consultation with litigation funders and other interested stakeholders, to deal with this area. This approach could be expected to provide an appropriate regime for judicial oversight of funders’ conduct of litigation. IMF is willing to work with any body proposed by the judiciary to develop such practice notes, directions or rules.

Submission 3.1: Informing clients of the options available to them for funding their litigation

4. As a preliminary point, IMF agrees with the Commission that some disputes are, by their nature, most appropriately resolved by the courts but that many individual consumers (and, we would add, small to medium business) are “poorly placed” to meet the costs associated with litigating disputes in court. The Commission has also drawn attention to the “critical asymmetry of information” that often exists between lawyer and client in relation to the quality of services to be provided by the lawyer and their cost.
5. The Commission considers that:
- “Placing an onus on lawyers to ensure that their clients understand upfront cost estimates (and any major changes to those estimates in the course of an engagement) would help address current problems with cost disclosure arrangements.”¹*
6. IMF agrees and submits that this obligation should also encompass a discussion about the options that may be available to the client to fund their litigation (including any adverse costs exposure), as is the case for solicitors in England and Wales.²
7. The relevant professional codes of conduct in each state and territory should reflect, an express obligation on a lawyer to discuss with the client, at the outset of the engagement, all available options for funding any litigation or other dispute resolution process the client wishes to pursue, including:
- 7.1. the basis for calculating the lawyer’s fees (hourly rate, fixed fee or blended fee);
 - 7.2. whether the lawyer is willing to work on a pro bono, conditional (“no win, no fee”) or (if the Commission’s recommendation is accepted by government) contingent fee basis and the estimated cost to the client of the option proposed;
 - 7.3. whether the lawyer will indemnify the client against any liability for adverse costs (and, if the lawyer agrees to do so, full information on the lawyer’s capacity to fund such liability);
 - 7.4. whether the client may be eligible for any public funding or assistance;
 - 7.5. whether any of the client’s costs or liabilities are, or could be, covered by insurance and how to apply for such insurance;

¹ Draft Report at 11.

² The ethical and professional obligations of solicitors in England and Wales are regulated by the Solicitors Regulation Authority Board (“SRA”). The SRA has published a Handbook (version 9, 1 April 2014) which includes the SRA Code of Conduct 2011. The Code seeks to give effect to 10 mandatory “Principles” which apply to all solicitors. The Code defines “Outcomes”, which show how the Principles apply in a practical context, and “Indicative Behaviours”. Conduct in accordance with the “Indicative Behaviours” may tend to show that solicitors have achieved the outcomes and complied with the Principles. Indicative Behaviour 1.15 states: “discussing how the client will pay, including whether public funding may be available, whether the client has insurance that might cover the fees and whether the fees may be paid by someone else such as a trade union.” See also reg 5(2)(c), The Damages-Based Agreement Regulations 2013 (SI 2013/ 609) (UK) which requires clients to be given equivalent information before a damages-based agreement is signed in an employment matter. The regulation is intended to extend the ethical obligation, which applies to solicitors under the Handbook, to non-solicitors (such as claims managers) who are entitled to conduct employment matters.

- 7.6. whether third party litigation funding might be available to the client and how to apply such funding; and
 - 7.7. whether any other body (e.g. a trade union) or person (e.g. an employer or family member) might be willing to meet some or all of the cost of the litigation.
8. Such an obligation:
- 8.1. would improve the information available to clients on which to base their decision to engage a lawyer and commence the litigation or alternative dispute resolution process (“ADR”);
 - 8.2. will heighten clients’ awareness of the costs of the litigation or ADR, including the risk of potentially having to pay an adverse costs order if any litigation is lost; and
 - 8.3. may improve access to justice for clients who lack the financial resources to pursue valid claims and who were unaware of the various funding options that may be available to them to progress their claims.

Submissions 3.2, 3.3: Removing the restriction on contingency fees

9. The Commission recommends:
- “Australian governments should remove restrictions on damages-based billing [i.e. contingency fees] subject to comprehensive disclosure requirements. The restrictions should be removed for most civil matters, with the prohibition on damages-based billing to remain for criminal and family matters, in line with restrictions for conditional billing.”³*
10. IMF accepts that allowing Australian lawyers to charge contingency fees would be likely to improve access to justice in this country and would also increase competition for litigation funding.
11. IMF nevertheless considers that the current model of third party litigation funding, with the funder operating at arms’ length to the lawyers, is superior to contingency fee charging by lawyers for the reasons set out at [4.68] – [4.72] of IMF’s initial submission to the Productivity Commission. In particular, IMF submitted at [4.70] that:
- “Third party litigation funding can reduce the agency problem by ensuring that the lawyer is remunerated regardless of the outcome to the litigation and by introducing a sophisticated and skilled repeat litigant whose interests are aligned with the claimant’s but who does not suffer the same level of information disadvantage as the claimant.”*
12. We also referred at [4.72] to arguments made by IMF’s John Walker, who noted that:
- “The policy considerations for requiring the traditional fiduciary duties of lawyers to their clients to be unfettered by any third party funding are compelling.”*
13. If the Commission’s draft recommendation 18.1 is accepted by government, however, IMF submits that lawyers who wish to act under a DBA should, in relation to their provision of funding for litigation under the DBA, be subject to appropriate elements of the regulatory regime that applies to litigation funders. This is discussed further below.

Submission 3.4: Contingency fee lawyers should potentially be liable for adverse costs

14. If lawyers are permitted to fund litigation on a contingency basis, they will inevitably face requests from their clients to cover adverse costs risks and to provide any security for costs that might be ordered (or risk the litigation being stayed or dismissed). That is, lawyers acting under DBAs might generally be expected to cover their clients’ adverse costs risk (or outsource this to litigation funders) as litigation funders do now.

³ Draft Recommendation 18.1.

15. However, IMF is concerned that in the event contingency fee lawyers do not agree to do so, the default rules which govern the courts' power to award costs against non-parties in the event an unsuccessful litigant lacks capacity to pay an adverse costs order, should clearly operate in exactly the same way for litigation funders and contingency fee lawyers. This is explained below.

Funders' liability to pay adverse costs

16. There are two bases on which litigation funders operating in Australia today may be liable to pay adverse costs if their clients' litigation is unsuccessful.
17. First, funders typically agree in writing to meet any costs the client might be ordered to pay the other party to the funded litigation, where those costs were incurred during the term of the funding agreement. Funders also, accordingly, agree to cover any security for costs the client might be ordered to provide.
18. In some cases, the funder will directly undertake to the defendant and the court to pay adverse costs and will agree to inform the Court if the funding agreement is terminated. In other cases, the funded party may undertake to the court and the other side that it will, if it loses the case, enforce an adverse costs indemnity against the funder or will assign it to the defendant and will, in any event, inform the defendant if the funding agreement is terminated.⁴
19. There are good reasons for funders adopting this position, not the least being that one of the main attractions of litigation funding for potential claimants is the protection it affords them against adverse costs orders, as well as the capacity it provides otherwise impecunious litigants to meet security for costs orders.
20. Funders and their clients nevertheless have a *choice* as to whether, as a matter of contract, the funder agrees to meet an adverse costs order. A client might prefer to retain that risk for itself, in return for the funder agreeing to take a lower percentage of any recoveries.
21. The High Court has held (by a majority) that it is not necessarily an abuse of process for a funder to agree to fund litigation but not provide any undertaking to pay adverse costs if the litigation is lost: *Jeffery & Katauskas Pty Ltd v SST Consulting Pty Ltd* ("**Jeffery**").⁵
22. Where a funder has not agreed to underwrite its client's adverse costs risk and the client later loses the litigation, the second basis on which a funder may be liable for adverse costs becomes relevant. This arises from the courts' discretionary power to award costs against non-parties to litigation, where it is in the interests of justice to do so.
23. While non-party costs orders are exceptional⁶, such an order can be made against a litigation funder whether or not the funder has control over the conduct of the litigation or has contractually agreed to pay adverse costs.⁷ However, the funder's contractual obligations and all other relevant circumstances of the case (including the reason, if any, for why no such indemnity was agreed) will be taken into account by the court in deciding whether to exercise its discretion to make a non-party costs order against a funder.
24. In *Knight v FP Special Assets Ltd* the High Court considered whether a receiver should be liable to pay an adverse costs order in respect of litigation run and lost by the company under receivership. The company, and not the receiver, was party to the litigation. Mason CJ and Deane J (with whom Gaudron J agreed) set out some general principles on which a non-party costs order will be made:

"For our part, we consider it appropriate to recognise a general category of case in which an order for costs should be made against a non-party and which would encompass the case of a receiver of a company who is not a party to the litigation.

⁴ *The Australian Derivatives Exchange Ltd v Doubell* [2008] NSWSC 1174.

⁵ [2009] HCA 43.

⁶ In the sense that such orders are a departure from the general principles that costs orders are only made against parties to litigation and "costs follow the event", that is the unsuccessful litigant is required to pay the costs of the successful litigant.

⁷ New South Wales Law Reform Commission, *Security for costs and associated costs orders*, Report 137 (2012), [3.16]; Mason P in *Fostif Pty Limited v Campbells Cash and Carry Pty Limited* [2005] NSWCA 83 at [120]: "Defendants . . . may obtain special costs orders against funders if proceedings fail"; Damian Grave, Ken Adams and Jason Betts, *Class Actions in Australia* (2nd ed, 2012), [17.920].

*That category of case consists of circumstances where the party to the litigation is an insolvent person or man of straw, where the non-party has played an active part in the conduct of the litigation and where the non-party, or some person on whose behalf he or she is acting or by whom he or she has been appointed, has an interest in the subject of the litigation. Where the circumstances of a case fall within that category, an order for costs should be made against the non-party if the interests of justice require that it be made.*⁸

25. In *Gore v Justice Corporation*⁹ the Full Court of the Federal Court ordered a litigation funder to pay the respondent's party and party costs incurred from the date on which the funder commenced funding the applicant's case.
26. The funder had initially agreed, in a written funding agreement, to pay the applicant's costs of determining the amount of damages it was owed by the respondent (the applicant having won the issue of liability at trial) and to meet the respondent's costs, if the applicant was unsuccessful. This commitment was made known to the respondent. The funding agreement also provided that the applicant was to retain control of the litigation.
27. The respondent ultimately won the case on appeal and the applicant was ordered to pay the respondent's costs. The applicant could not pay. Unknown to the respondent, three days before the appeal hearing, the funder and the applicant purported to cancel the funding agreement and replace it with a "loan" that lacked any obligation on the funder to pay adverse costs. The loan was not disclosed to the respondent until the respondent sought its costs from the funder.
28. The Court held the funder liable to pay that part of the respondent's costs that related to the period of funding, reasoning that:

*"If Montague [the applicant] had been successful there was every likelihood that there would have been a costs order against Clayton Utz [the respondent], thereby recouping to Justice Corporation [the funder] much of what it had outlaid by way of expenditure on Montague's costs. It seems to us, as a logical consequence of these circumstances, that in return for the chance of obtaining 8 per cent of the judgment debt and a recoupment of much of its outlay for costs, Justice Corporation should be expected to incur the risk of a costs order in the event of Clayton Utz being the successful party. Reaching that conclusion is made easier because of the provision in the Litigation Agreement under which Justice Corporation agreed with Montague that it would pay Clayton Utz's costs in the event of Montague losing the case. That factor should not, however, be treated as the catalyst for the Court arriving at its decision. It was a matter of great significance that the existence of this clause was made known to Clayton Utz but it was still only one of the factors that has led this Court to its conclusion."*¹⁰

29. On the other hand, the *Jeffery* decision is exceptional in this context. In that case, the funder had paid legal costs incurred by its client in the New South Wales Supreme Court and on appeal, but had declined to provide an indemnity against adverse costs. The client, who was insolvent, ultimately lost the case. The defendant sought an order that the funder pay its outstanding costs of \$450,000.
30. The High Court held that the Supreme Court could not make an order holding the funder liable to pay the defendant's costs because the particular rules which then applied in the Supreme Court prevented this. The rules provided, in effect, that a costs order could only be made against a non-party who had committed a contempt of court or an abuse of process. The High Court held neither applied. Those rules have since been repealed, leaving the NSW Supreme Court with an "essentially unfettered" discretion to make a costs order against a litigation funder (or other non-party) in the future, whether or not the funder had engaged in contempt or an abuse of process.¹¹

⁸ [1992] HCA 28 at [34].

⁹ [2002] FCA 354, (2002) 189 ALR 712.

¹⁰ *Ibid* at [64].

¹¹ Damian Grave, Ken Adams and Jason Betts, *Class Actions in Australia* (2nd ed, 2012), [17.1000].

Lawyers' liability to pay adverse costs

31. The superior courts have inherent jurisdiction to make personal costs orders against solicitors (as part of the courts' supervisory jurisdiction over legal practitioners) and all courts have statutory authority to do so in certain circumstances. For instance, solicitors may be liable to pay costs if they have been guilty of serious misconduct or neglect or have been responsible for improperly or unreasonably causing a party to litigation to incur costs.¹² These sorts of orders, while made from time to time, are rare.
32. However, a clear distinction is drawn between the position of commercial litigation funders and lawyers who act on a "no win, no fee" (or conditional fee) basis, even though the lawyers are effectively providing funding for their client's litigation. In most jurisdictions, lawyers who do so are entitled to be paid their reasonable fees and disbursements and an uplift percentage on those fees, if the litigation is won, to reflect the risk they run of the case, and their fees, being lost.
33. While courts sometimes base the award of costs against a non-party litigation funder on the ground that the funder "is the effective litigant standing behind the actual party,"¹³ lawyers are not regarded in the same light.¹⁴ We are not aware of any reported decision in Australia in which lawyers were held to be liable to pay adverse costs or provide security for costs solely on the ground that they had funded their client's litigation under a conditional fee agreement.¹⁵
34. This approach is exemplified in the decision of the Full Federal Court in *Madgwick v Kelly*,¹⁶ where Allsop CJ and Middleton J said:

"There are principled reasons to distinguish between a commercial litigation funder and solicitors such as Macpherson and Kelley under these agreements. The former take a percentage of the judgment; the latter earn professional fees. Here, the fees could not rise above costs as recovered. Solicitors are entitled to charge professional fees for undertaking the professional responsibilities of running the case, as officers of the Court, with all the attendant responsibilities (including duties to the Court) that that entails. No one, the solicitors included, should ever lose sight of those responsibilities. The expected or contingent receipt of proper professional fees (and there was not the slightest suggestion here that Macpherson and Kelley's fees, including the "case management fee", were other than proper) is not a basis for requiring an officer of the Court to contribute to a fund for the costs of the other side of the litigation. Looking at the matter from the point of view of the solicitors, it could not be considered reasonable for them to be required to fund on an ongoing basis the litigation brought under Pt IVA."

35. The Courts are clearly concerned to facilitate access to justice (subjecting lawyers to the risk of adverse costs or requiring them to provide security for costs might discourage them from acting for impecunious clients on a conditional basis¹⁷), but the laws relating to the award of costs against lawyers predate the development of litigation funding and, even more recently in countries outside of the United States, contingency fees. IMF submits they are not appropriate for contingency fee arrangements.

¹² For example, *Civil Procedure Act 2005* (NSW), s 99. See New South Wales Law Reform Commission, *Security for costs and associated costs orders*, Report 137 (2012), [3.66] – [3.67].

¹³ Cf *Knight*, note 8, [20] per Dawson J.

¹⁴ See, eg, *Hughes v Janrule Pty Ltd* [2011] ACTCA 15.

¹⁵ The position is different in Canada. In *Poulin v Ford Motor Company of Canada Limited* 2007 CanLII 56490 (Ont. SC) the Court awarded costs to the defendants following the plaintiff's failure to obtain certification for a class action. The defendants sought orders against the plaintiff's co-counsel. The Court found that the counsel had entered into a contingency fee agreement with the plaintiff under which they were to receive 33% of any recoveries. They did not indemnify the plaintiff against adverse costs. The Court ordered that the costs be paid by the lawyers. It found that US counsel was the "underwriter of the litigation" and Canadian counsel "were an integral and significant part of the team." The Judge said: "*The fact remains that at the time of instituting the action and mounting the Certification Motion, Mr Poulin was without an indemnity undertaking and it was accordingly open [to co-counsel] to obtain extremely large fees arising from a successful outcome without any concomitant risk of adverse cost consequences.*" These findings were upheld on appeal: *Poulin v. Ford Motor Company of Canada* 2008 CanLII 54299 (Ont. SCDC).
¹⁶ [2013] FCA FC 61 at [47].

¹⁷ *Shackles v Broken Hill* [1996] 2 VR 427, 430: "Solicitors who undertake to act for an impecunious client at risk to themselves are in principle in no different position. Indeed, it has been said that by so acting they are performing a commendable public service, consistent with the best traditions of the legal profession."

Why should contingent fee lawyers be liable to pay adverse costs?

36. IMF submits that any distinction, between commercial litigation funders' potential exposure to adverse costs and that of lawyers, should be removed if Australian lawyers are permitted to act on a contingency fee basis. This is for the reasons set out below.
37. First, as Maurice Blackburn has submitted to the Commission, allowing lawyers to charge contingency fees will promote competition with litigation funders, to the potential benefit of consumers, and will promote access to justice.¹⁸ IMF agrees with that assessment. Litigation funders and contingency lawyers are likely, in IMF's view, to operate in the same or similar markets.
38. There is no reason why, if contingency fee lawyers are to be competitive with litigation funders, the lawyers should enjoy an advantage over funders through immunity to pay adverse costs. Such an arrangement seems, on its face, to undermine rather than promote competition.
39. Second, it is well recognised that the risk of having to pay adverse costs discourages parties from bringing meritless or frivolous litigation in Australian courts. This risk, and the prophylactic role it plays in civil litigation, should apply equally to litigation funders and contingent fee lawyers.
40. Third, both claimants and defendants have a real and legitimate interest in whether the lawyers are liable to pay adverse costs. The position of claimants has been discussed above.
41. As far as defendants are concerned, there will be no difference between litigation brought against them by a litigation funder or by a law firm acting on a contingency fee. In both cases, the defendant will seek reassurance that its costs will be met if the litigation is lost. The defendant's risks will be significantly increased if the lawyers act under a DBA for a "person of straw" and have declined to indemnify that person against any adverse costs orders. While the defendant might obtain security for costs against the claimant (which the lawyers may have to fund, if the proceedings are to continue), security is not always available and the amount ordered may not cover all of the defendant's costs in the event the case is lost (as occurred in *Jeffery*).
42. Fourth, the reluctance of courts to require lawyers, acting under currently sanctioned conditional fee agreements, to pay adverse costs or provide security for costs, because the lawyers stand to recover (if the case is successful) no more than their conventional solicitor and client costs (and an uplift if permitted), does not apply to contingency fee charging. Under a DBA a lawyer may recover many times his or her conventional fees. The lawyer's entitlement is, in any event, calculated by reference to the value of the judgment or settlement recovered by the claimant and not the work performed by the lawyer.
43. Fifth, equalising the risks of facing an adverse costs order as between funders and lawyers would not limit access to justice. Allowing DBAs on the basis IMF puts forward is likely to increase access to justice. Further, this change will be made while retaining the right of lawyers to act under conditional fee agreements, so if lawyers are unwilling to take on the risk of funding adverse costs, they may act on a conditional basis where they will continue to enjoy substantial immunity from such costs.

Submission 3:5: Lawyers' liability for adverse costs should be mandated by law

44. It is possible that, if DBAs were legalised in Australia, courts may decide, in appropriate cases, to impose liability to pay adverse costs on lawyers who fund litigation under such arrangements.¹⁹

¹⁸ Letter from Maurice Blackburn to the Productivity Commission, 8 November 2013, [13.10], [13.22], [13.25], [13.35].

¹⁹ In *Madgwick v Kelly* [2013] FCAFC 61 at [149] Jessup J left open "the wider question of when, if at all, the size of the uplift in fees, in the event of a successful outcome in a case, would turn a solicitor into a person for whose benefit the litigation was commenced [and therefore potentially liable to provide security for costs]." His Honour, consistently with the current prohibition on contingency fees, expressly noted that the "uplift" must not be "related to the award received by the applicant in the proceeding" and is "otherwise within the limits permitted by any applicable legislation."

45. However, IMF submits that to avoid any doubt the court's power to award costs against such lawyers should be expressed in legislation or rules of the court, rather than left to the development of the common law.²⁰ Subject only to this clarification, the courts' discretion as to whether to award costs against a funder or lawyer should remain unrestricted in all cases.
46. This reform could be achieved by including a rule in the Uniform Civil Procedure Rules (or equivalent) along the lines of the following:

- “(1) *The Court may make an order that a party to proceedings may recover costs from a person who is not a party to the proceedings (non-party) if:*
- (a) it is satisfied, having regard to all the circumstances of the case including the terms of any contract between the non-party and a party to the proceedings, that it is in the interests of justice to make such an order; and*
 - (b) the non-party has contributed or agreed to contribute to the costs of a party to the proceedings in return for a share of any money or property which that party may recover in the proceedings; and*
 - (c) the non-party has been afforded a reasonable opportunity to make submissions to the court before the order is made.*
- (2) *The non-party may be a solicitor or counsel who:*
- (a) is retained by a party to the proceedings; and*
 - (b) satisfies the conditions in (a) to (c) of rule (1).²¹*

Submission 3.6: Comprehensive disclosure requirements for DBAs

47. IMF agrees with the Commission's recommendation that if DBAs are to be permitted, they should be subject to comprehensive disclosure requirements. These should be mandated in regulations (perhaps made pursuant to State legal profession legislation or the national scheme) and should, at a minimum, specify:
- 47.1. the work to be undertaken by the lawyer and/or the claim, proceedings or part of the proceedings to which the DBA relates;
 - 47.2. the percentage fee payable to the lawyer on success and how it is calculated;
 - 47.3. the definition of “success” for the purposes of the DBA and when the percentage fee is payable by the client;
 - 47.4. the practices adopted by the lawyer to manage any conflicts of interest that might arise as a result of the lawyer's contingent funding of the litigation, as is required of litigation funders by the *Corporations Amendment Regulation 2012 (No 6)* and ASIC's Regulatory Guide 248;
 - 47.5. the client is advised to obtain independent legal advice on the DBA before signing it;
 - 47.6. a cooling off period;
 - 47.7. the conditions under which the DBA may be terminated and the consequences of any termination;

²⁰ It appears to be the position in England and Wales, where DBAs have been allowed in virtually all contentious matters since 1 April 2013 as part of the Jackson reforms, that it will be up to the courts to determine a solicitor's liability for adverse costs under a DBA in the absence of agreement between the solicitor and client. A working party of the Civil Justice Council on Damages Based Agreement recommended, wrongly in IMF's respectful view, that the immunity enjoyed by solicitors acting under conditional fee agreements from having to pay adverse costs orders (in accordance with the Court of Appeal's decision in *Hodgson v Imperial Tobacco Limited* [1998] 1 WLR 1056) be extended to DBAs. This recommendation does not appear to have been accepted. The Damages-Based Agreements Regulations 2013 (SI 2013/609) are silent on the point.

²¹ This draft is based on Rule 25.14 of the Civil Procedures Rules of England and Wales.

- 47.8. whether the lawyer is liable to indemnify the client against any adverse costs;
 - 47.9. whether the client has any liability to any party (including the lawyer) for any fees, costs, disbursements or other amounts over and above the percentage fee (including adverse costs, if the lawyer is not funding these) and the circumstances in which these amounts become payable; and
 - 47.10. that the client is entitled to, and does receive prior to signing the DBA, adequate disclosure of the law firm's financial position and capacity to meet its obligations under the DBA for the expected life of the agreement.
48. If contingency fee lawyers, in their role as litigation funders, are to be subject to the regulatory regime that applies commercial litigation funders (as IMF submits should be the case), some of the disclosure requirements in respect of DBAs will more appropriately be dealt with under the ASIC regulatory regime.

Submission 3.7: No percentage limit on DBAs

49. No limit should be imposed on the maximum percentage payable to a lawyer who wishes to act under a DBA, as the Commission asks in its Information Request 18.1. The percentage should be subject to negotiation between the lawyer and his or her (fully-informed) client. In reality, competition between contingency fee lawyers and litigation funders will keep percentages to the minimum necessary to adequately compensate the lawyer for the risks assumed under the DBA.
50. In addition, sufficient protections exist under current law to prevent lawyers from entering into or enforcing an unjust, unconscionable or unethical DBA, but the law should mandate a cooling off period for DBAs and a requirement that clients be informed of their right to take independent legal advice on a DBA before signing it. IMF further submits below that contingency fee lawyers should be subject to appropriate licensing as litigation funders, which will provide additional protection to their clients.
51. IMF makes no submission in relation to the 25% limit on uplift fees in conditional billing arrangements, other than to note that the current prohibition in New South Wales on lawyers charging an uplift fee in damages claims²², is anomalous and should be repealed.

Submissions 3.8, 3.9: Regulation of litigation funders, including contingency fee lawyers

52. IMF agrees with the Commission's draft recommendation 18.2, that "*third party litigation funding companies should be required to hold a financial services licence, be subject to capital adequacy requirements and be required to meet appropriate ethical and professional standards.*"
53. This is a position that IMF has long advocated. However, the proposal to allow lawyers to fund litigation on a contingency basis raises an important issue of consumer protection and regulatory neutrality as between contingent fee lawyers and litigation funders.
54. Lawyers who choose to employ DBAs in large numbers or in major civil litigation (such as class actions) will face increasing and potentially significant financial risks as the amount of such litigation increases in their practices. Cash flow issues could become acute for such law firms, notwithstanding the fact that law firms, in comparison to litigation funders, typically have more diversified sources of income.
55. IMF reiterates a point it made in its initial submission to the Commission (at [4.41]). Litigation funders provide financial support to cases claiming billions of dollars. They make financial promises which extend over many years and which, if broken, will cause much heartache and financial distress to their clients. It is important to the clients, defendants and the courts that funders have both longevity and ongoing financial capacity. Funders play, for the plaintiff, a similar role to that played by insurers for the defendant. Insurers are required to be licensed and the same must surely apply to litigation funders.

²² *Legal Profession Act 2004 (NSW)*, s 324(1).

56. These observations apply with equal force to lawyers acting under DBAs. In these circumstances, IMF submits that lawyers who wish to act under a DBA should, *in relation to the financial aspects of their litigation funding activities only*, be subject to appropriate elements of the regulatory regime that applies to commercial litigation funders. That is, contingency fee lawyers should, at a minimum, be subject to:
- 56.1. prudential supervision by ASIC;
 - 56.2. a requirement to have adequate risk management systems in place; and
 - 56.3. a requirement that they provide a financial services guide and product disclosure statement (prior to any DBA being signed) which explains, in plain English, the principal terms of the proposed funding and what clients need to know to assess the suitability of a DBA for their needs.
57. Lawyers who fund litigation on a contingency basis should also be explicitly subject to the conflicts management requirements of the *Corporations Amendment Regulation 2012 (No 6)* (C'th), which require funders to develop procedures to manage conflicts of interest which may arise by virtue of the relationships between funders, funded parties and their lawyers, to the extent that such conflicts are not already adequately regulated by legal professional ethics.
58. The details of such regulation should be determined as part of the consultation process proposed by the Commission in relation to the regulation of litigation funders. IMF recognises that lawyers are already subject to considerable regulation in relation to their professional obligations to the court and their clients. These obligations would not be affected by IMF's proposal, which instead focuses on the additional measures that necessarily arise out of contingency fee lawyers' role in funding litigation.
59. As noted, IMF looks forward to working constructively and efficiently with Treasury and ASIC (and any other body the Government may establish for this purpose) to develop the appropriate licence and regulatory requirements applicable to litigation funders (including contingency fee lawyers).

Submissions 3.10, 3.11: Court oversight of funders' behaviour

60. The final area IMF wishes to raise with the Commission in these submissions is in relation to the Commission's draft proposal that litigation funders be subject to explicit ethical standards and that their conduct be supervised by the courts.
61. IMF agrees with the recommendation made by the Victorian Law Reform Commission in its 2008 *Civil Justice Review*, referred to by the Commission on page 545 of the draft report, that litigation funders and insurers, as well as litigants and legal practitioners, should be subject to "overriding obligations" in relation to the conduct of civil proceedings.²³
62. The Commission refers to the *Code of Conduct for Litigation Funders* which has been published by the Association of Litigation Funders of England and Wales and considers that "there would be some value in the industry developing a similar code in Australia" as it could "serve as guidance for the courts in overseeing the behaviour of litigation funders."²⁴
63. While IMF agrees with the general thrust of the Commission's report in this respect, in IMF's submission it would be preferable to work with the courts themselves in developing ethical or conduct standards to regulate litigation funders' and (if permitted) contingency fee lawyers' interaction with the court system. IMF is willing to work with the courts and interested stakeholders in developing such standards.

²³ The Supreme Court of Western Australia has introduced rules requiring "interested non-parties" to litigation (which term includes litigation funders) to be identified to the court and to use reasonable endeavours to achieve the "overriding objective": Supreme Court Amendment Rules 2012, Order 9A.

²⁴ Draft Report, page 546. Note that in his Final Report on the *Review of Civil Litigation Costs*, Jackson LJ accepted the use of a voluntary code of conduct for litigation funders in England and Wales because the industry there was "still nascent", but that "if the use of third party funding expands, then full statutory regulation may well be required": Rt Hon Lord Justice Jackson, *Review of Civil Litigation Costs: Final Report* (December 2009), chapter 11, [2.4].