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NOTES

DAVID VS. GOLIATH PATENT CASES: A SEARCH FOR THE MOST PRACTICAL MECHANISM OF THIRD PARTY LITIGATION FINANCING FOR SMALL PLAINTIFFS

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I. INTRODUCTION

"Nearly every man who develops an idea works it up to the point where it looks impossible, and then he gets discouraged. That's not the place to become discouraged."
-Thomas A. Edison

Small private entities and individuals comprise a very small percentage of plaintiffs in high-tech patent litigation. The American legal system has given them the tool, in the form of patents, to protect their breakthroughs from infringement. Despite having this tool, inventors often lack the means to wield it for its intended purpose. The low percentage of small entities and individuals that file high-tech patent lawsuits may well be explained by the fact that the cost of intellectual property litigation is prohibitive to these entrepreneurs in asserting their legal rights against what are, oftentimes, much larger allegedly infringing entities which possess far greater means to defend against legal attack.

There are multiple third party litigation funding alternatives for these patentees; some that have been utilized for years, and others that are just now gaining acceptance. This article briefly explores each of these methods in search of the most practical approach for patent plaintiffs, and concludes that some newly emerging methods of third party litigation finance are best suited to help level the playing field for these David-versus-Goliath plaintiffs.

II. BACKGROUND

Individuals and small private entities have long been a formidable presence in bringing about the innovations that drive technological development and economic progress.[1] Yet the cost of pursuing litigation to enforce the patents

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1. One commentator noted that:

> [A]n examination of more than 1,300 inventors listed in the May 27, 1997 *Official Gazette of the USPTO* showed a full 50 percent of domestic patentees came from entities with one thousand employees or less, or from the nonprofit sector. While large corporations are obviously an important piece of the

that protect the creative ingenuity of these innovators has expanded well beyond their reach.[2] It has been noted that these costs are a likely catalyst in causing such a large number of patent lawsuits to be settled in relation to the small number that are adjudicated based on their merits.[3] In fact, most patent cases are settled quickly, within about twelve to fifteen months after the complaint is filed.[4] Moreover, the allegedly infringing defendants frequently have greater financial resources for litigation than the patent-holders.[5]

One study demonstrates the effects of this imbalance of wealth on the outcome of patent lawsuits filed by individuals, finding that "individual plaintiffs had only half as good a chance as corporations to win patent infringement suits,"[6] and concluding that "[t]he wealth disparity very likely helps accused infringers to prevail by putting more effort into the case than the patent owners on average do."[7] In fact, the study found that the largest accused infringers in the data set (firms with over $1 billion in revenue) had by far the lowest chance of losing a patent infringement case.[8]

Another survey found that small entities, dismayed by potentially overwhelming legal costs, are less likely to litigate to protect their patents, despite a belief that their patents are infringed upon at a higher frequency than

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> innovation community, they also have more options than the smaller entities and are probably less dependent on the patent system in the first place.

Scott Erickson, *Patent Law and New Product Development: Does Priority Claim Basis Make A Difference?*, 36 AM. BUS. L.J. 327, 336-37 (citations omitted).

2. "According to a 2009 economic survey commissioned by the American Intellectual Property Law Association (AIPLA), in patent infringement cases where the amount in dispute is less than $1 million, the total litigation costs can outweigh the amount at stake. In those where the amount at stake is between $1 million and $25 million, total litigation costs average in excess of $3 million. In cases where the amount in dispute exceeds $25 million, average total litigation costs are roughly doubled." William R. Towns, *U.S. Contingency Fees: A Level Playing Field?*, WORLD INTELL. PROP. MAG. (February 2010), http://www.wipo.int/wipo_magazine/en/2010/01/article_0002.html.

3. Jay P. Kesan & Gwendolyn G. Ball, *How Are Patent Cases Resolved? An Empirical Examination of the Adjudication and Settlement of Patent Disputes*, 84 WASH. U. L. REV. 237, 264 (2006) (noting that, according to the authors' data, approximately 80% of patent cases settle, which is "…cause for significant concern that the high transaction costs associated with patent litigation create incentives for parties to settle and inhibit the ability of the courts to rule on the validity and infringement of patent rights"). *Id.* at 311 (summarizing that patent litigation costs are a driving force of this finding, and that "rulings on the merits by the courts concerning patent validity, patent infringement, and remedies for infringement, i.e., injunctive relief or damages, are rare, expensive, and not pursued to completion by most litigants"). *See also* Jean O. Lanjouw & Mark Schankerman, *Protecting Intellectual Property Rights: Are Small Firms Handicapped?*, 47 J.L. & ECON. 45, 56 tbl.2 (2004) (reporting that about ninety-five percent of lawsuits initiated by independent inventors between 1978 and 1999 were settled).

4. Kesan & Ball, *supra* note 3, at 311.

5. Paul M. Janicke & LiLan Ren, *Who Wins Patent Infringement Cases?*, 34 AILPA Q.J. 1, 42 (2006).

6. *Id.* at 21. According to the data compiled and examined, individual patentees won 12% of patent cases studied, in contrast to the overall patentee win rate of 24.4%. *Id.*

7. *Id.* at 42.

8. *Id.* at 17.

those held by large corporations.[9] This data lends credence to the assertion that a rational would-be infringer may decide to infringe after taking into account the financial weakness of a small business or individual patentee, knowing that the risk of enforcement is relatively low,[10] and that if such patentees decide to litigate, their relative lack of financial strength strongly correlates with the outcome of the case.[11]

An oft-cited case that underscores the plight of these individual inventors is that of Robert Kearns, inventor of the intermittent windshield wiper used in vehicles.[12] Ford Motor Company refused Kearns's offer to license his technology and proceeded to infringe on his patent.[13] After years of Ford allegedly stalling litigation, Kearns had racked up $10 million in legal expenses before obtaining his second favorable judgment.[14]

As a possible result of such disparities, individuals and small private entities brought only five and twelve percent of high-tech patent lawsuits, respectively, between January 1, 2000 and March 21, 2008.[15] Faced with such a daunting landscape, some observers have expressed fear that individuals and small entities are being discouraged from developing new ideas and then seeking patent protection for those ideas.[16] Two schools of thought regarding solutions might be borne out of the realities faced by these plaintiffs. First, perhaps the existing litigation system ought to be reformed and overhauled. Or, second, alternative resolution methods within the existing systematic framework of litigation ought to be explored.

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9. Jeff A. Ronspies, *Does David Need a New Sling? Small Entities Face a Costly Barrier To Patent Prosecution*, 4 J. MARSHALL REV. INTELL. PROP. L. 184, 197 (2004) (citing Josh Lerner, *The Patent System and Competition* 4, http://www.ftc.gov/opp/intellect/lernerjosh.pdf (last visited Dec. 28, 2010)). Ronspies also noted that in a survey of 376 companies in 1990, legal costs were a factor in deciding whether to litigate for twice as many small entities as large companies. *Id.*

10. Stuart J.H. Graham & Ted Sichelman, *Why Do Start-Ups Patent?*, 23 BERKELEY TECH. L.J. 1063, 1086 (2008).

11. Janicke & Ren, *supra* note 5, at 14 (noting the "finding that financial strength is significant when considered alone and also when considered in a regression with the other factors" in predicting the outcome of a patent lawsuit).

12. Ronspies, *supra* note 9, at 196.

13. *Id.* (citing John Seabrook, *The Flash of Genius*, NEW YORKER, Jan. 11, 1993, at 38).

14. *Id.* (citing *The Week In Review, No Shortage of Saviors*, WASH. TIMES, June 14, 1992, at A14).

15. Colleen V. Chien, *Of Trolls, Davids, Goliaths, and Kings: Narratives and Evidence in the Litigation of High-Tech Patents*, 87 N.C. L. REV. 1571, 1600 (citing data derived from the Stanford Intellectual Property Litigation Clearinghouse, http://www.law.stanford.edu/program/centers/iplc/ (last visited Jan. 28, 2011)). The data examined tracked suits involving hardware, software, and financial patents filed between Jan. 1, 2000 and Mar. 21, 2008. *Id.* at 1593. Small private entities are those with less than $10 million in annual revenue. *Id.* at 1614, app. A.

16. *See* Ronspies, *supra* note 9, at 203, 211 ("Litigation costs…act as a disincentive for small entities to patent their innovations…[and] the ability of the small-entity inventor to obtain and enforce patent rights is becoming an increasingly difficult financial burden to bear. The extreme cost of protecting a patent through litigation may result in fewer patents filed by small entities and thus less innovation.").

The first path, reforming or overhauling the current system, which might include the implementation of non-litigation-based alternatives for solving patent disputes, such as compulsory arbitration or some form of patent defense union,[17] or hybrid methods such as a mutual insurance association that would first mandate arbitration for members,[18] is beyond the scope of analysis here. Instead, we will focus on the second path.

In light of the fact that small plaintiffs usually lack the funds to mount a patent prosecution on their own, the current legal landscape dictates that they must turn to third party litigation finance.[19] But which form? This article seeks to examine the available alternatives and determine which among them is the most practical to help level the playing field for small private entities and individuals seeking to assert their legal rights in enforcing high-tech patents they hold against larger entities; so-called "David-versus-Goliath" cases.

For these individuals, unlike some plaintiffs, such as those in personal injury or product liability cases, methods of having the litigation financed by a third party are more limited, given the particularly complex and expensive nature of patent litigation. Among the available funding arrangements are contingency fee arrangements, loans, patent insurance, and, more recently, non-recourse funding and transfers of interest.[20] As will be examined, some of these solutions may have more utility for plaintiffs in other types of cases, or even for somewhat

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17. Such solutions have been suggested for application in the European Union. *See* WILLIAM KINGSTON, ENFORCING SMALL FIRMS' PATENT RIGHTS (2000).

18. *See* Mark C. Vallone, Note, *System and Method of Funding SMEs Commencing Patent Infringement Disputes*, 56 SYRACUSE L. REV. 181, 189-97 (2005). *But see* J. Rodrigo Fuentes, *Patent Insurance: Towards a More Affordable, Mandatory Scheme?*, 10 COLUM. SCI. & TECH. L. REV. 267 (2009) (calling for statistical studies similar to those conducted in Europe to analyze the viability of implementing a mandatory patent insurance scheme in the United States).

19. The term "third party litigation finance," for purposes of this article, indicates a lawsuit that is financed by funds from a source other than the direct parties to the litigation. While the concept has sparked some controversy, its access-to-justice benefits are also increasingly recognized by commentators. *See, e.g.*, Susan Lorde Martin, *The Litigation Financing Industry: The Wild West of Finance Should Be Tamed Not Outlawed*, 10 FORDHAM J. CORP. & FIN. L. 55, 56-57 (2004) (stating that "litigation financing firms can provide a worthwhile service to level the playing field in lawsuits when defendants have much greater resources available than plaintiffs"); Lauren J. Grous, *Causes of Action for Sale: The New Trend of Legal Gambling*, 61 U. MIAMI L. REV. 203, 205 (2006) (stating that "[l]itigation financing companies can tip the scales in what would otherwise be a David versus Goliath-type situation – with the necessary cash, plaintiffs need not become victims of a sophisticated defendant with significant resources").

20. Michael L. Lovitz, Connolly Bove Lodge & Hutz LLP, American Law Institute - American Bar Association Continuing Legal Education Presentation: Strategies for Funding IP Litigation: Insurance and Other Avenues (October 19-20, 2006). Note, however, that the laws within certain jurisdictions prohibit some of these arrangements from being available to plaintiffs. While a passing reference to these laws may be made herein, an in-depth discussion is not within the scope of this article. *See generally* Maya Steinitz, *Whose Claim Is This Anyway? Third Party Litigation Funding*, 95 MINN. L. REV. 1268, 1286-99 (2011). *See also* Paul Bond, Comment, *Making Champerty Work: An Invitation to State Action*, 150 U. PA. L. REV. 1297 (2002).

larger entities suing over a patent, but simply are not practical for their individual or small entity counterparts.[21]

III. OUR STORY BEGINS

Forgive us, if you will, for engaging a cliché law school hypothetical for illustrative purposes. Our story begins with Ida Inventor, who had an innovative idea and designed a high-tech device that she hopes will revolutionize the daily lives of people near and far. She spent much of her savings to hire a competent patent attorney, who patented her idea, giving it protection from being imitated by a would-be competitor. As she sat down to breakfast one morning, she tuned in to the cable business news station on the television. To her shock and horror, the leading story proclaimed that Conglomo-Enterprises (a large fictional company) is introducing a product which uses her patented idea as a key component. Ida is but one humble inventor who now wishes to assert her legal rights against Conglomo-Enterprises for patent infringement. What are her options with respect to financing such a legal battle? In the pages that follow, we will follow Ida's journey in search of the most practical option for her and others like her.

IV. THIRD PARTY LITIGATION FINANCE SOLUTIONS

A. Contingency Fee Arrangements

Ida has heard of contingency fee arrangements. In fact, as a layperson, it was one of the first ideas that sprang to her mind. Like most of us, she has seen her share of television commercials, ranging from humorous and corny to downright somber, urging injured individuals to contact a particular law office to explore their legal options for obtaining redress against an alleged wrongdoer. The commercials promise that the attorney will not be paid unless the outcome of the client's case is successful; indeed, this is the very nature of contingency fee arrangements.[22] However, Ida seems to only recall hearing about such arrangements when someone has been physically injured.[23] She wondered: are such arrangements available for patent litigation?

As a matter of fact, contingency fee arrangements are available in intellectual property cases. The practice, while not as widely known and publicized as that for personal injury and product liability cases, has been in use

21. *See infra* Section IV.
22. Steinitz, *supra* note 20.
23. William E. Jackson, *Contingency Fee Representation in Intellectual Property Cases*, 1 U. BALT. INTELL. PROP. L.J. 207 (1993) (noting that contingent fee representation is well established in the practice areas of personal injury and product liability).

for decades by some practitioners.[24] Indeed, some very high-profile patent cases have been made possible by lawyers willing to work under a contingency fee arrangement.[25]

However, the number of lawyers willing to take such cases on a contingency fee basis is small, due to a number of complicating factors, which are quickly pointed out, even by those willing to work under these arrangements.[26] Chief among them is the very nature of a patent lawsuit; it is likely to be complex, drawn-out, and expensive to fight.[27] Other difficulties include the burdensome task of evaluating damages,[28] as well as the fact that there is little incentive for skilled patent lawyers to work based on contingency fees, since there is much work to be done that is paid on an hourly basis.[29] Despite the potential for windfall financial rewards for such practitioners,[30] such risks result in few attorneys who are willing to represent patent litigation clients on a contingency fee basis.[31] Given these risks and complexities, while an individual plaintiff with a personal injury claim would have no difficulty finding a lawyer willing to work on a contingency fee basis, one with a meritorious patent claim "may find that the best law firms for [his or her] case would prefer to charge by the hour."[32]

Additionally, if one is able to find a lawyer willing to litigate a patent claim on a contingency fee basis, the upfront and ongoing costs that many assess directly to clients in order to retain their services have been estimated to be in the range of $20,000,[33] which is likely a significant sum to a small business or individual. Contingency fee practitioners must be able to evaluate the damages at stake from the outset in order to determine whether to take on a particular case which, as previously noted, is a complex proposition in patent cases.[34] In order to do so, some require both an infringement opinion and a validity opinion from

24. P.L. Skip Singleton, Jr., *Justice For All: Innovative Techniques for Intellectual Property Litigation*, 37 IDEA 605, 610 (1997) (noting that attorney Alfred Engelberg began litigating patent cases in 1985 on a contingency fee basis).

25. *See supra* note 12 and accompanying text. Independent inventor Robert Kearns' struggle against Ford Motor Co. and others he accused of stealing his idea for intermittent windshield wipers was brought to the big screen in the 2008 movie "Flash of Genius." FLASH OF GENIUS (Intermittent Productions 2008); Kearns v. Ford Motor Co., 32 F.3d 1541 (Fed. Cir. 1994). Kearns was represented on a contingency fee basis by Arnold, White & Durkee, P.C. *Id.*

26. Singleton, *supra* note 24, at 608.

27. *Id.*

28. *See* Jack L. Slobodin & Seyfarth Shaw, *Examining Damages Experts in Patent Litigation*, PATENT LITIGATION 2003, 667, 669 (2003), *available at* WL 766 PLI/Pat 667.

29. Singleton, *supra* note 24, at 608.

30. *See id.* at 610. By 1997, attorney Alfred Engelberg had received more than $100 million in contingency fees, when the same litigation taken on an hourly basis would have yielded a mere $15 million. *Id.*

31. *Id.* at 608.

32. Jonathan T. Molot, *Litigation Finance: A Market Solution to a Procedural Problem*, 99 GEO. L.J. 65, 74 (2010).

33. Ronspies, *supra* note 9, at 198 (citing John P. Costello, *Patent Enforcement with Teeth*, INVENTORS DIG., May 1, 1999).

34. Slobodin & Shaw, *supra* note 28.

a first attorney, which can cost close to $10,000.[35] If the lawyer agrees to represent the inventor under a contingency fee arrangement after this analysis, additional costs, estimated to at least match those of the infringement and validity opinions by a first attorney, include expenses for depositions, travel, and evidentiary exhibits.[36]

Thus, the lack of lawyers willing to take patent litigation cases on a contingency fee basis, coupled with significant upfront and ancillary costs payable directly by the inventor, results in a relatively impractical option for financing patent litigation brought by the small entity or individual patentee.

B. Loans and Non-Recourse Funding

Ida also wonders what sort of options may be available if she (or her law firm) needs to borrow money in the form of a loan in order to finance the litigation. If she is unable to find a lawyer to take her case on a contingency basis, Ida will need funds to pay the lawyer's hourly rate, or her lawyer may opt to borrow funds to cover these fees while the litigation proceeds. If a lawyer does take Ida's case on a contingency fee basis, the law firm will likely need to borrow money to cover the high costs of the litigation.[37] As it turns out, there are two subcategories of lenders that may consider loaning money to Ida or her lawyer: traditional lenders, and another group known as cash advance or "non-recourse" funding companies.

1. Traditional Lenders

One of the obstacles an individual or small business would face in trying to secure a loan in present times from a traditional lender is the current economic climate. The results of a recent Federal Reserve senior loan officer survey painted a picture of hesitation and tightened standards in certain sectors of the lending arena.[38] Certainly, the availability of funds depends upon the type of loan being sought, as well who is seeking the loan.[39] For instance, an individual such as Ida may consider taking out a home equity loan, a cash advance on a credit card, or a personal loan[40] (or some combination of methods), and a

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35. Ronspies, *supra* note 9, at 198 (citing John P. Costello, *Patent Enforcement with Teeth*, INVENTORS DIG., May 1, 1999) (noting that in 1999, the average cost of an infringement opinion was $5,000, and the average cost of a validity opinion was $3,750).

36. *Id.* (estimating ancillary costs to be approximately $10,000).

37. Bond, *supra* note 20, at 1330 (noting that "many small plaintiffs' firms finance their operations through bank loans").

38. Sudeep Reddy, *Banks Keep Lending Standards Tight*, THE WALL STREET JOURNAL, May 4, 2010, http://online.wsj.com/article/SB10001424052748704342604575222363579664310.html.

39. *Id.*

40. Any of these arrangements would have to be repaid regardless of the outcome of the litigation. Further, gaining access to the hundreds of thousands or even millions of dollars required to finance such litigation via a home equity loan or credit card is an extremely unlikely proposition for most individuals, particularly with the weak housing market wiping out homeowners' equity.

business like her lawyer's firm (the size of which can obviously vary) would probably seek a business loan. Overall, however, the survey revealed that more than two-thirds of loan officers responded, on average, that their current standards and terms are more stringent than they have been historically.[41]

If these common types of loans are not an option, a borrower may seek a specialized loan product with repayment tied to a potential recovery. In addition to the challenges presented by the current economic climate, traditional lenders are generally ill-equipped to finance litigation in this manner. After taking an application, a bank must evaluate the request to borrow funds, which is routine enough in cases of individuals taking out a home equity loan or credit card, where methods such as credit reports and home appraisals provide the bank with a means to determine the likelihood of the loan being repaid or the adequacy of the collateral. But evaluating a request for a loan to an individual or a law firm with only the potential litigation recovery as collateral is anything but routine, because valuing a claim is much more complex and uncertain than valuing, say, a tangible asset.[42] Typically, such valuation is the domain of experienced trial lawyers and insurance claims adjusters rather than loan officers.[43] Further, in the case of a law firm, if it operates primarily on contingency fees, it does not have accounts receivable like other firms that operate on an hourly or flat fee basis.[44] Finally, there are usually no installment payments to be made on such loans, no set maturity date, and it is often difficult to enforce a security interest in anticipated recoveries.[45] In order to be compensated for such risks and uncertainties, the appropriate interest rate on a subject loan may likely violate usury laws.[46] While it was noted in 2004 that some banks had started a new line of business by extending these lines of credit to contingency lawyers,[47] they

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41. Reddy, *supra* note 38.

42. Douglas R. Richmond, *Other People's Money: The Ethics of Litigation Funding*, 56 MERCER L. REV. 649, 651 (2005) (noting that "the lender may have no means of valuing…varied cases.").

43. *Id.* at 650-51.

44. *Id.* at 651 (citing Mike France, *The Litigation Machine*, BUS. WK. ONLINE, Jan. 29, 2001, http://businessweek.com/2001/01_05/b3717001.htm.).

45. *Id.* at 651.

46. Lovitz, *supra* note 20. S*ee generally* Richmond, *supra* note 42, at 665 (discussing usury).

47. Although the practice areas of the firms to whom these lines of credit are extended are not noted,

> Sunwest Bank of Tustin in Orange County, California has targeted law firms that take cases on a contingency basis because lawyers in southern California are well known for winning huge awards from juries. Not only do these lawyers repay their lines of credit, but they put the proceeds of these cases in the bank, and they refer clients to the bank. In addition, banks can charge contingency-fee lawyers higher rates because the business is riskier, banks can require personal guarantees or lawyers' personal residences as collateral, and the banks may require the lawyers to provide a monthly list of cases and expenses. Other banks in Oregon, Tennessee, and Louisiana also view these lawyers as a unique opportunity to make money in the financing business because there is little competition.

frequently employ cumbersome application, documentation, reporting, and oversight requirements,[48] and use firm assets, such as real property and future fees, as collateral.[49] Indeed, with such burdensome standards and collateral requirements for law firms seeking these loans, we could find no indication of banks being willing to engage in this lending practice with individuals. Despite the opportunism of a few traditional lenders, many or all of which may have subsequently ceased lending in this arena after the advent of the current recession, most are simply unwilling to lend money to fund litigation in light of the associated risks.[50]

Therefore, using a traditional lender to fund litigation is rarely, if ever, a practical option for these plaintiffs or their attorneys.

2. Cash Advance / Non-Recourse Funding Companies

A specialized group of companies recently emerging seeks to fill the market gap left by traditional lenders. These companies have discovered that by structuring their products as non-recourse funding, they are able to reap the potential rewards for taking a high risk without running afoul of government regulations. For instance, the funding arrangements charge a fixed interest rate versus a percentage of the plaintiff's potential recovery, thus freeing them from laws prohibiting maintenance and champerty.[51] And, by making repayment contingent upon a recovery, the interest rate assessed can be high enough to compensate for the risk that the lawsuit may result in a judgment for the defendant or a recovery that is smaller than the sum borrowed, without violating usury laws.[52]

Depending on the lender, this funding may be made available either directly to plaintiffs, or the law firm that is representing them.[53] In the case of the latter, it may allow a plaintiff access to a risk-averse firm with a strong reputation in patent law that ordinarily represents clients on an hourly fee basis, since such funding would allow the firm to take on a potentially lucrative patent case on a

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Martin, *supra* note 19, at 72-73 (citation omitted).

48. Richmond, *supra* note 42, at 651.

49. Steven Garber, *Alternative Litigation Financing in the United States: Issues, Knowns, and Unknowns*, RAND Institute for Civil Justice Law, Finance, and Capital Markets Program, 13 (2010), *available at* http://www.rand.org/content/dam/rand/pubs/occasional_papers/2010/RAND_OP306.pdf.

50. *See* Richmond, *supra* note 42, at 651.

51. Molot, *supra* note 32, at 94. "'Maintenance' is officious intermeddling in a suit which in no way belongs to the intermeddler by…assisting either party to the action, with money or otherwise, to prosecute or defend it…. 'Champerty' is a type of maintenance in which the intermeddler makes a bargain with one of the parties to the action to be compensated out of the proceeds of the action." 14 AM. JUR. 2D *Champerty, Maintenance, and Barratry* § 1 (2010).

52. Molot, *supra* note 32, at 94. S*ee generally* Richmond, *supra* note 42, at 665 (discussing usury).

53. Molot, *supra* note 32, at 98. However, lending directly to law firms is likely to take a form other than non-recourse. *See supra* note 49 and accompanying text.

contingency fee basis.[54] In fact, some non-recourse funding companies require a plaintiff's attorney to be working on a contingency fee basis as a prerequisite for funding approval, thereby excluding any plaintiffs who may intend to borrow money upfront to fund their attorney's hourly billing.[55] These lenders are common in the personal injury arena, but a survey of the websites of members of the American Legal Funding Association (an industry trade group[56]), as well as those of a few other selected lenders in the industry, revealed that a fair number also fund in commercial claims cases, with several even specifically noting that they are willing to lend money for patent or intellectual property litigation.[57]

The primary drawback to these arrangements, for any potential borrower, is the interest rate that is assessed. These rates are sometimes well in advance of 100%, which would certainly run afoul of usury laws if they applied to these arrangements.[58] In a well-known Ohio case, albeit one involving a personal injury victim, the interest rates on two cash advances taken by the plaintiff were calculated to be 180% and 280%, respectively.[59] The shady practices in this

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54. Molot, *supra* note 32, at 100. Such a scenario is outlined:

> [T]he law firm might take the case on a contingent fee basis, the financier might lend money to the law firm in amounts that would cover its hourly fees (or an agreed upon amount that might be discounted from its regular hourly fees), and the law firm would repay the loan plus interest out of its contingent fee. Under this…scenario, the law firm would be guaranteed its hourly fee, for if the case results in a lower recovery, the terms of the non-recourse loan would not entitle the lender to recover any more than the law firm collected in the case. But if the contingent fee ended up exceeding the hourly billings by an amount large enough to cover accrued interest and leave extra profit for the law firm, the law firm would reap those benefits.

Id.

55. "You must be represented by an attorney on a contingency fee basis." Chestnut Hill Funding, http://www.chestnuthillfunding.com/site/692107/page/2306637#Q2 (last visited Jan. 20, 2011).

56. ALFA's stated purpose is:

> To establish and maintain the highest ethical standards and fair business practices within the legal funding industry; To represent ALFA's members and their interests to regulators, legislators, the media and the public; To develop awareness of the industry and to ensure that information about the industry is accurately disseminated; and To establish a legal and regulatory framework in individual states, that meet the needs and concerns of all parties interested in legal funding.

http://www.americanlegalfin.com/FactsAboutALFA.asp (last visited Jan. 20, 2011).

57. *See infra* app. A. The websites did not specifically indicate whether the funding associated with these claims is non-recourse, or if it involves claim transfer (*see* discussion *infra* Part IV.D.2.), but the companies surveyed are not those that seem to typically specialize in commercial claims via claim transfer. *See* Garber, *supra* note 49, at 15 (listing companies that have been noted to specialize in funding commercial claims via claim transfer).

58. *See*, *e.g.*, Rancman v. Interim Settlement Funding Corp., No. 20523, 2001 WL 1339487, at *1 (Ohio Ct. App. Oct. 31, 2001) (noting the lower magistrate's holding that the loans violated the usury interest law).

59. *Id.* at *1. However, "it is hard to know whether the percentages cited in Rancman…exemplify those in the industry in general." Susan Lorde Martin, *Financing Litigation On-Line: Usury and Other Obstacles*, 1 DEPAUL BUS. & COMM. L.J. 85, 98 (2002).

particular corner of the litigation funding industry that have occurred in the past have led some commentators to examine such funding as a type of sub-prime lending,[60] which can encourage plaintiffs to settle early for lower amounts.[61] Although the interest rates charged to law firms for such funding may be lower than those charged to plaintiffs,[62] these methods have, of late, given way to alternate methods of funding, such as transfers of interest, which may be better suited to commercial cases such as patent disputes.[63]

Thus, despite increased availability of funds from cash advance/non-recourse companies vis-à-vis traditional lenders, small entities or individuals looking to fund patent infringement suits would be best advised to examine their other options before committing to such an arrangement.[64] The chances are good that more attractive alternatives are available that will bolster their bargaining power, as well as that of their lawyers.[65]

C. Offensive Patent Insurance

Ida has pondered other situations in her life that could lead to litigation. For instance, she could be in a car accident, or a guest in her home could fall down the stairs. But she pays for insurance to offset the risk of financial liability in scenarios such as these. Could she have purchased insurance for her patent that would have offset the risk of expensive litigation in the case of infringement?

Patent insurance is available to reimburse patentees for litigation expenses, up to a policy-specific limit, incurred while defending their patent against infringement. This allows a policyholder to spread the litigation risk to a third party. However, some problems, similar to those already discussed, also are present with offensive patent insurance. To begin with, there are few firms operating in the patent insurance field,[66] which minimizes competitive forces that benefit consumers. This is likely due to the risks involved, some of which can be quantified through a complex underwriting process,[67] and others that cannot.[68]

60. *See* Martin, *supra* note 19.

61. Molot, *supra* note 32, at 101.

62. Such interest rates can "still be quite high – 25% per year or greater, depending upon the risk involved." *Id.* at 98 (citing JURIDICA INVESTMENTS LIMITED, PROSPECTUS 30, http://www.juridicainvestments.com/en/investor-relations/~/media/Files/J/Juridica/pdfs/Admission_Documentation.pdf) (last visited Jan 17, 2011)).

63. *See* discussion *infra* Part IV.D.2.

64. Even some funding companies in this industry have encouraged plaintiffs "to explore all other means available to them before considering" a non-recourse loan. Bridge Funds, http://www.bridge-funds.com/ethics.hrm (last visited Jan. 20, 2011).

65. Molot, *supra* note 32, at 101.

66. Fuentes, *supra* note 18, at 271.

67. Such as the litigiousness of the insured, and the industry in which they operate. *Id.* at 288.

68. Such as changing laws. *Id.* An example is the increased difficulty of obtaining an injunction in the wake of *eBay v. MercExchange*, which led to higher litigation expenses and, by extension, increased risk for insurers. *Id.* (citing eBay v. MercExchange, 547 U.S. 388 (2007)).

Another drawback is that the policy must be bought before any infringement is known to have occurred.[69] Effectively, if infringement predating the policy is discovered during the claims approval process, or even subsequent to approval, the approval will be denied or revoked, and the insured must reimburse any litigation expenses paid by the insurer in the case of the latter.[70] A patentee like Ida would not be eligible, given that the infringement has occurred and she did not have a policy in place prior to it.

Perhaps one of the highest barriers that would prevent these patentees from availing themselves of coverage is the expense associated with such policies. These costs take the form of upfront costs prior to coverage, premium costs required to maintain the policy, and other costs associated with the policy. First, like some contingency fee lawyers, certain patent insurance companies require significant upfront fees to be paid by the patentee in order to examine the patent and determine whether it is eligible to be covered under their policy.[71] Second, the average premiums for an offensive patent infringement litigation insurance policy may also be out of reach for this group of patentees, quoted by one insurer at roughly $14,500 annually for a single patent with a $2 million policy limit and "average risk."[72] This would result in premium costs of close to $300,000 over the life of the patent.[73] Last, but not least, there are the additional costs that are associated with the coverage. Before submitting a claim under the policy, the insured must first obtain an infringement opinion from an attorney,[74] the cost of which can range from $10,000 to $100,000, depending on a number of factors, including complexity and the insured's industry.[75] A cost of $30,000 is a reasonable estimate for the average infringement opinion.[76] If a monetary settlement results from the litigation, the insured is typically required to share

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69. Ronspies, *supra* note 9, at 209.

70. Fuentes, *supra* note 18, at 278-79.

71. Lisa A. Small, *Offensive and Defensive Insurance Coverage for Patent Infringement Litigation: Who Will Pay?*, 16 CARDOZO ARTS & ENT. L.J. 707, 743 (1998) (noting that Lloyd's of London employs lawyers and accountants to pre-screen patents and select those for coverage that are "legally valid and valuable" for coverage. This examination requires a fee of $25,000 to be paid by the entity seeking review and subsequent coverage if approved.).

72. Intellectual Property Insurance Services Corporation [hereafter "IPISC"], http://www.patentinsurance.com/products/insurance-policies/abatement/ (last visited Jan. 20, 2011).

73. Based on an average annual premium cost of $14,500 multiplied by the twenty-year lifespan of a patent.

74. Fuentes, *supra* note 18, at 287 (citing IPISC, Intellectual Property Infringement Abatement Insurance Policy Specimen 9-10 (2000)).

75. *Id.* (citing Edwin H. Taylor & Glenn E. Von Tersch, *A Proposal to Shore Up the Foundations of Patent Law that the Underwater Line Eroded*, 20 HASTINGS COMM. & ENT. L.J. 721, 740 (1998)).

76. From a large New York law firm. Fuentes, *supra* note 18, at 287 (citing Interview with Henry Lebowitz, Partner, Fried, Frank, Harris, Shriver & Jacobsen LLP in New York, N.Y. (Apr. 11, 2008)).

the award with the insurer at 1.25 times the amount the insurer has covered in litigation expenses.[77]

Moreover, an insured seeking to submit a claim will face an arduous task best accomplished by a lawyer, fraught with additional expenses.[78] Finally, if a claim is approved and litigation proceeds, the insurance carrier will have a good deal of involvement in and control over the litigation.[79] This includes requiring the insurer's approval of the insured's chosen litigation counsel, the proposed litigation budget, and additional approval for any possible appeals.[80]

Therefore, given the expenses and aforementioned barriers associated with offensive patent insurance, it is unlikely to be a reasonable consideration for most small entity and individual patentees.

D. Transfers of Interest

Ida is running out of ideas; there seem to be many drawbacks to all of those that she has explored so far. She ponders for a moment whether she has access to anything else of value that she can leverage in order to fund the legal defense of her patent. Then, she realized that she has two things. First, she owns the patent that she is seeking to defend. Second, she expects proceeds from the litigation that she is going to bring against Conglomo-Enterprises for infringing on her patent. Is there any way that she can leverage either of these?

In short, yes. Companies exist that seek to purchase the rights to patents in order to leverage their financial strength to extract licensing fees from other companies wishing to utilize the patent.[81] Further, some investment funds and banks have somewhat recently begun directly investing in lawsuits by purchasing the rights to a portion of the potential recovery, particularly in commercial

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77. Small, *supra* note 71, at 743 (policy underwritten by Lloyd's of London).

78. Vallone, *supra* note 18, at 188. An overview of the process is as follows:

> To make out a claim, the policyholder must, among other things, submit a detailed outline of the proposed litigation, copies of warning letters sent to suspected infringers, a report showing efforts made to license the patent, a letter prepared by patent counsel identifying the patent claims alleged to be infringed and rendering an opinion as to the patent's validity and infringement, including a description of prior art discovered subsequent to the issuance of the patent . . . . The policy claim also must describe the article considered to constitute infringement, a description of the patent holder's product falling within the scope of the patent, a description of the evidence to be introduced to prove infringement, a budget projection for litigation expenses, a credit report on the infringing parties, and a copy of the complete prosecution file . . . . [I]f there are multiple, independent infringers, the insurance carrier must insist that wholly separate claims be supplied for each infringer.

Id. at 188-89 (citation omitted). *See also* Fuentes, *supra* note 18, at 281.

79. Fuentes, *supra* note 18, at 281 (citing IPISC, Intellectual Property Infringement Abatement Insurance Policy Specimen at 6, 10 (2000)).

80. *Id.*

81. Lovitz, *supra* note 20, at 6.

litigation, such as patent disputes.[82] One of the driving forces behind this development, in addition to the growing permissibility of the practice in international jurisdictions, has been the global recession.[83] The resulting demand has come from both sides of the table, with investors clamoring for financiers to seek new asset classes of investments "not cyclically correlated with bonds and equities," and cash-strapped businesses looking to offload litigation risk.[84]

1. In Intellectual Property Rights

One arrangement of funding litigation via transfer of interest requires a plaintiff like Ida to sell or license the rights to her patent to a third party, sometimes referred to as a non-practicing entity (NPE).[85] In exchange, the inventor receives a share of revenue generated or an agreed-upon cash sum.[86] The NPE would then proceed in prosecuting the patent.

The major concern for a patentee considering this method of funding litigation is common to all of the methods discussed: how much is this going to cost? In this instance, the "cost" is not in terms of an interest rate or out of pocket expenses, but whether the patentee is receiving a fair value for the patent from the NPE. As previously discussed, one of the complexities of patent litigation is the difficulty encountered in valuing a particular patent. Accordingly, though an NPE may not be able to accurately estimate the true value of a patent down to the dollar, it will almost certainly have more resources to do so. This may result in the NPE attempting to purchase the rights to the patent at a much-reduced price, and then subsequently licensing it for a

82. Molot, *supra* note 32, at 96.

83. Steinitz, *supra* note 20, at 1283-85.

84. *Id.* at 1284. There are "several layers of risk [in litigation] – from legal fees exceeding budgets to unfavorable judgments and unforeseen events." Juridica Investments, Ltd., http://www.juridicainvestments.com/en/about-juridica/corporate-claims-asset-class.aspx (last visited Feb. 5, 2011).

85. FTC, To Promote Innovation: The Proper Balance of Competition and Patent Law and Policy, ch. 2, at 31 (2003), http://www.ftc.gov/os/2003/10/innovationrpt.pdf. NPEs have come under intense scrutiny from many commentators, who frequently refer to them as "patent trolls." *See generally* Gerard N. Magliocca, *Blackberries and Barnyards: Patent Trolls and the Perils of Innovation*, 82 NOTRE DAME L. REV. 1809 (2007); Daniel J. McFeely, Comment, *An Argument for Restricting the Patent Rights of Those Who Misuse the U.S. Patent System to Earn Money Through Litigation*, 40 ARIZ. ST. L.J. 289 (2008). *But see* James F. McDonough III, *The Myth of the Patent Troll: An Alternative View of the Function of Patent Dealers in an Idea Economy*, 56 EMORY L.J. 189 (2006) (arguing that "patent trolls" benefit society by bringing "liquidity, market clearing, and increased efficiency to the patent markets – the same benefits securities dealers supply capital markets."); Sannu K. Shrestha, Note, *Trolls or Marketmakers? An Empirical Analysis of Nonpracticing Entities*, 110 COLUM. L. REV. 114 (2010) (using empirical data from the U.S. Patent and Trademark Office and the Stanford Intellectual Property Litigation Clearinghouse to test the arguments for and against NPEs).

86. "The client can receive a percentage of our net recoveries from licensing and enforcement, and in some cases an up-front cash payment." Acacia Technologies, LLC, http://acaciatechnologies.com/clientagreement.htm (last visited Jan. 28, 2011).

substantial fee, versus drafting an agreement that fairly compensates both the inventor as well as the NPE for taking on the litigation expenses.[87]

However, assuming a fair purchase price or licensing fee is agreed upon with the NPE, the patentee enjoys several benefits. First, the involvement of an NPE may increase the amount realized by the inventor for its patent, since a NPE would have the resources to assert a credible litigation threat, enhancing the bargaining position of the patent-holder.[88] One independent inventor affirmed this, referring to an NPE as his "saviour," and noting that although many patents had referenced his patent, since he had no resources to litigate he would not have netted any royalties had it not been for the NPE he worked with.[89] Second, in offloading the litigation risk, the inventor can resume their focus on creating new innovation.[90]

2. In Litigation Proceeds

Another method of funding litigation via transfer of interest involves a plaintiff selling all, or a portion of, his or her rights to the proceeds of the litigation to an investment firm or fund.[91] Indeed, a plaintiff retaining some slice of interest in the case seems preferable to investment companies or funds, because it would ensure the plaintiff's cooperation in the case (e.g., giving testimony) and would prevent a possible challenge by the defendant to the investor's standing to sue.[92] While this may at first seem analogous to the contingency fee, whereby a party other than the plaintiff acquires a right to a portion of the recovery, there are some important distinctions:

> One, the funder is not providing a service for a fee but rather is investing in an asset. Second, the funder–client relationship is unlike the very unique, and uniquely-regulated, attorney-client relationship. In fact, one of the characteristics of third party funding is that the client is often also represented by an attorney who can help negotiate the funding agreement. Third, litigation funding benefits corporate America as much as it does the Plaintiffs Bar and its clientele. Litigation funders are likely to develop ongoing relationships with both sides of this great divide. Fourth, and perhaps most crucial, funders are likely to engage

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87. A particularly disproportionate example is that of TechSearch. Shrestha, *supra* note 85, at 129 (citing McFeely, *supra* note 85, at 294) (discussing a $500 million patent infringement suit by TechSearch, an NPE, against Intel over a patent it acquired for a mere $50,000 at a bankruptcy sale).

88. Molot, *supra* note 32, at 97; Shrestha, *supra* note 85, at 127.

89. Jason Kirby, *Patent Troll or Producer?*, FIN. POST (Jan. 14, 2006), http://www.financialpost.com/story.html?id=1509d361-0144-4432-b6dc-2c14026c98d6 (quoting independent inventor Paul Ware's assessment of NPE Acacia Technologies, LLC).

90. Shrestha, *supra* note 85, at 127.

91. Lovitz, *supra* note 20, at 6.

92. *Id.*

> in secondary trading of the litigation stakes they purchase, [whereas] attorneys are not.[93]

Again, a primary consideration for plaintiffs pondering this arrangement is how much it will cost – the portion of the recovery that the investor commands in exchange for funding.[94] However, by assigning the rights to a portion of the proceeds and receiving an agreed-upon sum, albeit at a reduced rate, the correlated benefit is that the plaintiff effectively removes some of the uncertainty of the litigation.[95] In doing so, the infusion of cash would allow a plaintiff greater options in choosing counsel, since he or she could afford to retain a patent lawyer on an hourly basis versus being confined to the task of locating one of the few who are willing to work on a contingency fee basis.[96] It may also allow them to continue to grow their business even as the litigation proceeds by funding the research and development of other products,[97] or to cover other expenses.

In sum, individual inventor and small entity patent plaintiffs should enter into a claim transfer arrangement with caution to ensure that they receive a fair bargain. Like all forms of third party litigation finance, the primary concern is the cost to the plaintiff. However, claim transfer mechanisms present the most practical solutions for such patentees to finance the complex, high-stakes litigation that will protect their intellectual property, both in terms of increasing availability, as well as being uniquely tailored to suit the difficult set of circumstances faced by these inventors. [98]

V. CONCLUSION

Plaintiffs in any case face a myriad of challenges and barriers. The high costs of litigation are not a new phenomenon by any means. Nor is the concern that these costs may stifle the ability of small plaintiffs to assert their legal rights against larger defendants. However, these costs and the consequential disparity in access to the justice system are magnified when looked at through the lens of the small private entity or individual inventor seeking to protect their patent from a larger adversary, owing to the particularly complex nature of intellectual

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93. Steinitz, *supra* note 20, at 1293-94.

94. "As an example, 'for every $1 we invest, we might be entitled to an additional $2 if the outcome is successful' within a specified time." Barbara Rose, *Law, the Investment*, A.B.A. J., Sept. 2010, at 47 (quoting David Desser, managing director, Juris Capital Corp.).

95. Lovitz, *supra* note 20, at 6.

96. This form of litigation finance is particularly useful to "small, start-up companies with large intellectual property claims against established companies. The small start-up may need cash to fund the lawsuit, as the best patent lawyers are often at law firms that charge by the hour rather than working for a contingent fee." Molot, *supra* note 32, at 97 (citation omitted).

97. *Id.*

98. Molot, *supra* note 32, at 101 "Hedge-fund investment in commercial claims, particularly intellectual property claims, probably offers the most promising market solution to risk imbalances between small, one-time plaintiffs and large, repeat-player defendants." *Id.*

property claims. As a result, most of them are unable to bear such high costs, and must pursue alternative methods of funding their litigation, which presents a specific set of challenges. While many avenues of third party litigation finance, some of which have been in use for many years, may be open to their counterparts who have been injured in an accident or by an allegedly faulty product, far fewer are actually feasible for use by the small inventor-plaintiff.

Fortunately for these patentees, recent developments in the industry, such as transfers of interest, are more tailored to suit the unique nature of their claims. As outdated legislation is reformed, these solutions will be increasingly available. While there are still important considerations for these "David" plaintiffs before they choose to avail themselves of such arrangements, on the whole, they provide the best alternative yet among third party litigation funding alternatives to help level the playing field when taking on a "Goliath" infringer.

APPENDIX A

SURVEY OF NON-RECOURSE FUNDING COMPANIES (JANUARY 2011)

Members of the American Legal Finance Association (ALFA)[99]

Company Name	Website (Homepage)	Website Specifying Eligible Case Types	Commercial Litigation specifically noted as being eligible for funding?	Patent or Intellectual Property Cases specifically noted as being eligible for funding?
Bridge Funds	www.bridge-funds.com	http://www.bridge-funds.com/eligibility.htm	Y	Y
Cambridge Management Group, LLC	www.cmgcash.com	http://www.cmgcash.com/plaintiff_resources.html	Y	Y
Case Funding*	www.casefunding.com	http://www.casefunding.com/about/commerciallitigation/	Y	Y
Global Financial Credit, LLC	www.glofin.com	http://www.glofin.com/qualify.aspx	N	N/A
LawCash	www.lawcash.net	http://www.lawcash.net/html/case-types.html#other	Y	Y
LawMax Legal Finance	www.fundmycase.com/en/index.php4	http://www.fundmycase.com/en/eligibility.php4	Y	Y
Oasis Legal Finance, LLC	www.oasislegal.com	http://www.oasislegal.com/case_types/plaintiff/	N	N/A
Plaintiff Investment Funding, LLC*	www.legalfundingnow.com	http://www.legalfundingnow.com/faqs.html#10	N	N/A
Plaintiff Support Services	www.plaintiffsupport.com	http://www.plaintiffsupport.com/plaintiff/cases.html	N	N/A
Preferred Capital Funding	www.preferredcapitalfunding.com	http://www.preferredcapitalfunding.com/clients.html	N	N/A
PS Finance	www.psfinance.com	http://www.psfinance.com/lawsuit-financing-help	N	N/A
The Law Funder	www.lawfunder.com	http://www.lawfunder.com/	Y	N
Whitehaven	www.whitehavenplantifffunding.com	http://www.whitehavenplantifffunding.com/faq.asp#casetypes	Y	N
USClaims	www.usclaims.com	www.usclaims.com	N	N/A

*"Associate Members"

[99] http://www.americanlegalfin.com/alfa1/LinkClick.aspx?fileticket=Lm8x6cRYF6c%3d&tabid=71&mid=553 (last visited Jan. 16, 2011). The websites for Lawsuit Cash Advance and Lancaster Financial Corp., two other member companies listed, were unable to be located.

Selected Other (Non-ALFA Member) Non-Recourse Funding Companies				
Company Name	**Website (Homepage)**	**Website Specifying Eligible Case Types**	**Commercial Litigation specifically noted as being eligible for funding?**	**Patent or Intellectual Property Cases specifically noted as being eligible for funding?**
Allied Legal Funding	www.alliedlegalfunding.com	http://www.alliedlegalfunding.com/casetypes/commercial.html	Y	Y
American Legal Funding	www.americanlegalfunding.com	http://www.americanlegalfunding.com/content.asp?page_id=4	Y	N
Barrister Capital Group, LLC	www.barristercapitalgroup.com	http://www.barristercapitalgroup.com/types_of_case_we_fund.html	Y	N
Case Advance	www.caseadvance.com	http://www.caseadvance.com/faq#faq_2	N	N/A
Chestnut Hill Funding	www.chestnuthillfunding.com	http://www.chestnuthillfunding.com/site/692107/page/2041837	Y	Y
Fair Rate Funding	www.fairratefunding.com	http://www.fairratefunding.com/pre-settlement-loans.html	Y	Y
Golden Pear Funding	www.goldenpearfunding.com	http://www.goldenpearfunding.com/Plaintiffs_FAQ.html	N	N/A
Interim Funding, Inc.	www.interimfundinginc.com	www.interimfundinginc.com	N	N/A
Law Capital Enterprises, LLC	www.lawcapital.com	http://www.lawcapital.com/cases.php	N	N/A
Litigation Capital Investors	www.cash-now-for-accident-cases.com	http://www.cash-now-for-accident-cases.com/typesofcases.php	N	N/A
Magnolia Legal Funding	www.magnoliafunding.com	www.magnoliafunding.com	N	N/A
Plaintiff Funding Service	www.plaintifffunding.com	http://www.plaintifffunding.com/personal.html	N	N/A
SMP Advance Funding, LLC	www.smpadvance.com	http://www.smpadvance.com/pre-settlement-loan/	N	N/A

THE RISE AND REGULATION OF LITIGATION FUNDING IN AUSTRALIA

Michael Legg[*], *Edmond Park*[**], *Nicholas Turner*[***] *and Louisa Travers*[****]

I. INTRODUCTION

Litigation funding is, at its core, a contractual arrangement whereby a third party pays the cost of litigation and in return, if the case succeeds, receives a percentage of the proceeds.[1] Litigation funding has been argued to be an important and legitimate development that provides access to justice, allows for the spreading of the risk of complex litigation, and can improve the efficiency of litigation by bringing commercial considerations to bear.[2]

Since the High Court gave its ruling in *Campbells Cash and Carry Pty Limited v Fostif Pty Ltd*,[3] the Australian litigation funding industry has enjoyed

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1. *See, e.g.*, Keelhall Pty Ltd. (t/as "Foodtown Dalmeny") v. IGA Distribution Pty Ltd, (2003) 54 ATR 75, ¶77 ("'[W]here a third party in return for a stake in the outcome of proceedings shoulders the burden of litigation in terms of its management and meeting its costs, including the costs of the parties who are sued.'"); In the matter of ACN 076 673 875 Ltd [2002] NSWSC 578, ¶ 9, *available at* http://www.austlii.edu.au/cases/nsw/NSWSC/2002/578.html (referring to an agreement where one party agrees to fund the litigation costs of the other party in return for a percentage of a potential recovery); QPSX Ltd v. Ericsson Australia Pty Ltd.(No. 3), (2005) 219 ALR 1, ¶¶ 39-48 (noting that there was a contract between the parties regarding litigation funding); P Dawson Nominees Pty Ltd v. Multiplex Ltd., (2007) 242 ALR 11, ¶¶ 31-33, 2007 WL 2059115 (discussing the terms of a litigation funding agreement between a company and class action group members).

2. *See QPSX Ltd,* 219 ALR at¶ 54 (noting that it would not be in the "interests of justice" for the group members to pursue claims individually as few would be financially able to do so); Fostif Pty Ltd v. Campbells Cash & Carry Pty Ltd, (2005) 63 NSWLR 203, ¶ 104 2005 WL 847305 (noting that litigation funding may provide "access to justice"); Law Council of Australia, *Litigation Funding - Report to the Standing Committee of Attorneys-General* (Sept. 14, 2006), at 4, *available at* http://www.lawcouncil.asn.au/library/submissions.cfm? ("[A]ccess to justice is the primary public policy consideration that should drive and inform any discussion about litigation funding or any proposed regulation . . . ."). *See also* Michael Legg, *Shareholder Class Actions in Australia - The Perfect Storm?*, 31 UNSW LAW JOURNAL 699, 704 (2008), *available at* http://www.austlii.edu.au/au/journals/UNSWLawJl/2008/37.html [hereinafter Legg, *Shareholder Class Actions*] (discussing the purpose of litigation funding in shareholder class actions).

3. Campbells Cash and Carry Pty Limited v. Fostif Pty Ltd, (2006) 229 CLR 386, 2006 WL 2474982.

significant growth.[4] There are six or seven litigation funding companies in Australia at present[5] which account for about 95% of all litigation funding in Australia,[6] including two (IMF (Australia) Limited and Hillcrest Litigation Services Limited) listed on the Australian Securities Exchange (ASX).[7] In the financial year that ended June 30, 2009, IMF (Australia) Limited (IMF) received net income from litigation funding in the sum of $35,246,957, with total net income of $38,748,833.[8] This represented a 21% increase in profitability from the previous year.[9] In 2010, profits decreased as a result of the deferment of the resolution of major cases but IMF still received $18,718,276 net income from litigation funding.[10] There are also litigation funders based offshore, such as International Litigation Partners Pte Ltd and Comprehensive Legal Funding LLC, that have funded Australian legal proceedings.[11]

However, the operation and proper constraints on litigation funding remain a live issue, particularly concerning the possibility for harm to consumers and the abuse of court processes created by unregulated litigation funding markets.[12] This paper charts the rise of litigation funding in Australia and the options for regulation that have been considered.

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4. *See* Simon Dluzniak, *Litigation Funding and Insurance* (Mar. 2009), at 2, *available at* http://www.imf.com/au/pdf/Paper%20-%20Dluzniak.pdf ("The three main effects of Fostif will be: . . . cases funded by third party funders will not be delayed by interlocutory disputes over whether there is an abuse of process; . . . funder's involvement in cases they fund will increase; and . . . 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.").

5. *See* Dluzniak, *supra* note 4, at 2 (noting that there are six or seven litigation funding companies operating in Australia including IMF (Australia) Ltd).

6. Law Council of Australia, *supra* note 2, at 6.

7. Australian Securities Exchange, *available at* http://www.asx.com.au/asx/research/listedCompanies.do?coName=I and http://www.asx.com.au/asx/research/listedCompanies.do?coName=H (last visited Sept. 27, 2011).

8. IMF (Australian) Ltd, *2009 Annual Report* (2009) at 4*, available at* http://www.imf.com.au/announcements/Appendix%204E%20and%202009%20Full%20Year%20Annual%20Report%20-%2026%20Aug%2009.pdf (last visited Sept. 27, 2011) [hereinafter IMF, *2009 Annual Report*].

9. IMF, *2009 Annual Report, supra* note 8, at 4.

10. IMF (Australia) Ltd, *2010 Annual Report* (2010), at 4, *available at* http://www.imf.com.au/pdf/AnnualReport2010.pdf [hereinafter IMF, *2010 Annual Report*].

11. *See* Comprehensive Legal Funding, *The Company* (2010), *available at* http://www.comprehensivelegalfunding.com/about-the-company/about-the-company ("Comprehensive Legal Funding LLC is a US-headquartered company providing litigation funding to the Australian legal services market.").

12. *See Fostif Pty Ltd,* 63 NSWLR at ¶ 104 ("The law now looks favourably on funding arrangements that offer access to justice so long as any tendency to abuse of process is controlled."); Hall v. Poolman, (2007) 215 FLR 243, ¶ 378, 2007 WL 4219768 ("The facts of this case . . . [show] how a mammoth piece of litigation can be instigated, perhaps to the ruin of a defendant, with negligible 'access to justice' for those who have suffered a wrong but with lucrative reward for those who make a business of investing in law suits.").

II. WHAT IS LITIGATION FUNDING?

A. Background

Historically, litigation funding would have constituted a tort and/or a crime in all Australian jurisdictions because these jurisdictions prohibited one from improperly encouraging litigation (maintenance) and funding another's litigation for profit (champerty).[13] At common law, doctrinal concerns justified the prohibition - courts should not be used for speculative business ventures.[14] However, the motive for prohibiting litigation funding was to prevent abuses of process, including ". . . vexatious or oppressive litigation, elevated damages, suppressed evidence, suborned witnesses . . . for personal gain."[15] Currently, the Australian Capital Territory, New South Wales, South Australia and Victoria legislatures have abolished both maintenance and champerty as crimes and torts.[16] Maintenance and champerty are also probably no longer crimes at common law.[17] However, in jurisdictions that have abolished maintenance and champerty, the abolition does "not affect any rule of law as to the cases in which a contract is to be treated as contrary to public policy or as being otherwise illegal . . . ."[18]

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13. Standing Committee of Attorneys-General, Discussion Paper, *Litigation Funding in Australia* (May 2006), at 4, *available at* http://lawlink.nsw.gov.au/lawlink/legislation_policy/ll_lpd.nsf/vwFiles/LitigationFundingDiscussionpaperMay06.pdf/$file/LitigationFundingDiscussionpaperMay06.pdf; Legg, *Shareholder Class Actions*, *supra* note 2, at 702.

14. Standing Committee of Attorneys-General, *supra* note 13, at 4. *See also* Tony Chappel, *Litigation funders have reached our shores*, Oct. 6, 2009, *available at* http://www.deneysreitz.co.za/index.php/news/litigation_funders_have_reached_our_shores/ ("Jurists in [other Commonwealth] jurisdictions have, in recent years, also grappled with the problem of allowing access to justice, whilst preventing the abuse of court process in which courts become the venue for speculative business ventures.").

15. Standing Committee of Attorneys-General, *supra* note 13, at 4; Legg, *Shareholder Class Actions*, *supra* note 2, at 702; Michael Legg & Greg Williams, *The High Court Gives Litigation Funding Legitimacy, Yet Questions Remain*, 44 LAW SOCIETY JOURNAL 53, 54 (2006).

16. Standing Committee of Attorneys-General, *supra* note 13, at 5; *Civil Law (Wrongs) Act 2002* (ACT) §221(1), *available at* http://www.legislation.act.gov.au/a/2002-40/current/pdf/2002-40.pdf; *Maintenance, Champerty and Barratry Abolition Act 1993 No 88* (NSW) §§3, 4, *available at* http://www.legislation.nsw.gov.au/viewtop/inforce/act; *Criminal Law Consolidation Act 1935* (SA) sch 11§§1(3), 3(1), *available at* http://www.legislation.sa.gov.au/lz/c/a/criminal%20law%20consolidation%20act%201935/current/1935.2252.un.pdf; *Wrongs Act 1958* (Vic.) §32 (Vic.), *available at* http://www.legislation.vic.gov.au/Domino/Web_Notes and *Crimes Act 1958* (Vic.) §322A, *available at* http://www.legislation.vic.gov.au/domino/Web_Notes.

17. Standing Committee of Attorneys-General, *supra* note 13, at 5. *See also* Clyne v. N.S.W. Bar Ass'n (1960) 104 CLR 186, 203, 1960 WL 52200 ("It may be necessary some day to consider whether maintenance as a crime at common law ought not now to be regarded as obsolete."); Brew v. Whitlock, (1967) VR 449, 1966 VIC LEXIS 355, *3-6 (quoting Fletcher Moulton, LG, that it is "'indisputable that the old common law of maintenance is to a large extent obsolete'").

18. *Wrongs Act 1958, supra* note 16, at§32(2) (also providing that the abolition does not extend to ". . . any contract which would have been illegal and void before the commencement of the Abolition of Obsolete Offences Act 1969 . . ."); Standing Committee of Attorneys-General, *supra* note 13, at 5. *See also Maintenance, Champerty and Barratry Abolition Act 1993, supra*

Since 1995, under statutory powers of sale,[19] "insolvency practitioners may contract for the funding of lawsuits, if these are characterised as company property."[20] These suits often involve voidable transactions or misfeasance by company officers.[21] Litigation funding companies first started to service the insolvency market.[22] More recently, litigation funding has been used to finance and manage class actions, particularly in the securities and competition law (antitrust) areas.[23] The significance of the class action may be illustrated by the change in investments made by IMF.[24] In 2006, IMF held a portfolio of claims comprised of $144 million in insolvency investments, $274 million in commercial investments, and $526 million in group actions, compared with the

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note 16, at § 6 (providing that the abolishing legislation does not affect illegal contracts or those against public policy regardless of when the contract was made); *Wrongs Act 2002, supra* note 16, at § 221(2) (providing that the abolition of maintenance and champerty "does not affect any rule of law about—(a) the illegality or avoidance of contracts that are tainted with maintenance or are champertous; or (b) the misconduct of a lawyer who—(i) engages in conduct that would have been maintenance at common law; or (ii) is a party to a champertous agreement."); *Criminal Law Consolidation Act 1935, supra* note 16, at sch 11§ 3(2) (providing that the abolition does not affect "(a) any civil cause of action accrued before the abolition; (b) any rule of law relating to the avoidance of a champertous contract as being contrary to public policy or otherwise illegal; [or] (c) any rule of law relating to misconduct on the part of a legal practitioner who is party to or concerned in a champertous contract or arrangement.").

19. An example would be the powers of disposal given to a receiver to dispose of a company's property under the *Corporations Act 2001* (Cth) § 420(2)(b) and (g), *available at* http://www.comlaw.gov.au/Details/C2011C00013 (providing that a receiver may "lease let on hire or dispose of property of the corporation . . . [and] . . . "convert property of the corporation to money. . ."), and the powers of disposal accorded to a liquidator by *Corporations Act 2001* (Cth) § 477(2)(c), *available at* http://www.comlaw.gov.au/Details/C2011C00013 (providing that a liquidator may ". . . sell or otherwise dispose of, in any manner, all or any party of the property of the company . . . ."). *See also* Standing Committee of Attorneys-General, *supra* note 13, at 5.

20. Standing Committee of Attorneys-General, *supra* note 13, at 5. *See also* Re Movitor Pty Ltd (in liq), (1996) 64 FCR 380, 390, 1996 WL 1746321 ("A company liquidator has a power of sale similar to that which a trustee in bankruptcy under §§ 134(1)(a) and 135(1)(a) of the Bankruptcy Act, under § 477(2)(c) of the Corporations Law, he can 'sell or otherwise dispose of, in any manner, all or any part of the property of the company' in aid of performing his duty of realising the company's assets."); Re Tosich Construction Pty Ltd, (1997) 73 FCR 219, 233, 1997 WL 1882003 (noting that the Corporations Act "'authorises the liquidator to make an agreement to pay a percentage of such recoveries in return for assistance in running the action, because the section empowers the liquidator not only to sell, but to 'otherwise dispose of, in any manner'" company property) (quoting Major & St Mellons Rural District Council v. Newport Corporation, (1950) 2 All ER 1226, 1230-31)).

21. Standing Committee of Attorneys-General, *supra* note 13, at 5. *See, e.g., Re Tosich Construction Pty Ltd,* 73 FCR at 221-223, 237 (finding that a liquidator has the power to enter into a litigation funding contract for claims of voidable transactions); *Re Movitor Pty Ltd (in liq),* 64 FCR at 383, 393 (finding that a liquidator has the power to make an agreement regarding litigation funding in claims against company officers).

22. Standing Committee of Attorneys-General, *supra* note 13, at 5.

23. *See* Legg, *Shareholder Class Actions*, *supra* note 2, at 704-05 (discussing how litigation funding promotes class actions).

24. *See* Wayne Attrill, *Litigation Funding: Access to Justice in a Time of Economic Crisis*, Presented at Globalaw Asia Pacific Regional Meeting, Auckland (Feb. 20, 2009), 8, *available at* http://www.imf.com.au/pdf/ (noting the spread of investments from 2006 to 2008).

corresponding 2008 figures of $132 million in insolvency investments, $280 million in commercial investments and $928 million in group actions.[25] The class action has continued to grow in importance with IMF announcing its intent in 2010 to fund claims by customers against their banks to recover allegedly unfair penalty and late fees deducted from their bank and credit card accounts over the last six years.[26] The claim involves up to twelve local and foreign banks and includes over 230,000 bank and credit card accounts estimated to be worth $5 billion.[27]

Additionally, litigation funding has become an Australian export with IMF funding proceedings in South Africa, New Zealand, the United States and the United Kingdom.[28] In the United States, funding was provided to Uniloc USA to pursue patent infringement litigation against Microsoft.[29] Further funding of United States claims seems likely with IMF's Chairman Rob Ferguson observing:[30]

> [the Uniloc funding] . . . created a surprising awareness of IMF in the [United States] and thus a flow of proposals. Nothing has come from these as yet, mainly because of our tough due diligence process, which is appropriately tougher for foreign jurisdictions, but we are greatly encouraged by the scale of opportunities in the [United States] revealed by our trips and research. [31]

B. *Costs Rule in Australian Litigation*

The attraction or need for litigation funding is closely linked to the costs rule that operates in Australian litigation.[32] The usual costs rule in Australian

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25. *Id.*

26. Adele Ferguson & Michael West, *Fee Gouging: Banks Face Huge Class Action,* SYDNEY MORNING HERALD, May 12, 2010, *available at* http://www.smh.com.au/business/fee-gouging-banks-face-huge-class-action-20100512-uw8h.html; *Banks Have Unfairly Deducted Bank Charges for Years: Join Court Action to Get Your Money Back*, FINANCIAL REDRESS (2010), *available at* www.financialredress.com.au.

27. Ferguson & West, *supra* note 26; *Banks Have Unfairly Deducted Bank Charges for Years: Join Court Action to Get Your Money Back*, *supra* note 26.

28. IMF, *2010 Annual Report*, *supra* note 10, at 17.

29. IMF (Australia) Ltd, *Uniloc USA Inc.*, *available at* http://www.imf.com.au/cases.asp?ID=89 (last updated Feb. 24, 2011). *See also* Uniloc USA, Inc v. Microsoft Corp, No. 2010-1035, 2010-1055, 2011 U.S. App. LEXIS 11, (Fed. Cir. Jan. 11, 2011); IMF (Australia) Ltd, *Uniloc USA v. Microsoft - Judgment Further Update, Release to Australian Securities Exchange*, Jan. 7, 2011, *available at* http://media.wotnews.com.au/asxann/01140223.pdf (discussing the outcome of the Uniloc case).

30. IMF, *2010 Annual Report*, *supra* note 10, at 6-7.

31. *Id.* *a*t 6.

32. *See* Ruddock v. Vadarlis, (2001) 115 FCR 229, 234-35 ¶ 11 (discussing when courts award costs in Australian and English cases). Costs include "attorney's fees and out-of-pocket expenses referred to as disbursements." Michael Legg & Louisa Travers, *Necessity Is the Mother of Invention: The Adoption of Third-Party Litigation Funding and the Closed Class in Australian*

litigation is that a losing party is liable for the other side's costs, albeit only a portion of the costs actually incurred.[33] This is referred to as "the loser pays" or "costs follow the event" and is usually given effect procedurally through an adverse costs order.[34] The rule is modified in relation to class actions as the costs rule applies to the representative party only and not to the group members.[35] This approach to costs has been raised as a disincentive to the commencement of litigation as the plaintiff, or representative party in a class action, is liable for the costs of its opponent if litigation is unsuccessful.[36] Equally, the approach discourages unmeritorious litigation to the extent that the risk of paying the other side's legal costs creates a financial disincentive to commence the litigation.[37]

The Australian and American fee rules differ in the United States in that the fee arrangements between lawyers and clients are less permissive in Australia than in the United States because Australia does not allow fees to be determined by a client's recovery (i.e. contingency fees).[38] Australian lawyers may take cases on a "no win no fee" basis[39] and, in some Australian states, if they are successful, charge their base rate multiplied by some factor or a specified additional amount.[40] This provides a mechanism to address the disincentive to

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Class Actions, 38 COMM. L. WORLD REV. 245, 252 (2009) [hereinafter Legg & Travers, *Necessity Is the Mother of Invention*].

33. *Ruddock,* 115 FCR at 234-35 ¶ 11; Hughes v. Western Australia Cricket Ass'n (1986) 19 FCR 10, 1986 WL 589981. The Victorian Law Reform Commission estimates that only sixty to seventy percent of costs are recovered. Victorian Law Reform Commission, *Civil Justice Review - Report 14* (2008) 648, *available at* http://www.lawreform.vic.gov.au.

34. *Ruddock,* 115 FCR at 234 ¶ 11; In the United States this approach is referred to as the "English Rule" on costs. *See* Hensley v. Eckerhart, 461 U.S. 424, 443 n.2 (1983) (Under the "English Rule," "the losing party, whether the plaintiff or defendant, pays the winner's fees."). In Australia, an adverse costs order is "[a] court order requiring a party to court proceedings to pay the other party or parties costs in relation to court proceedings. Costs in relation to court proceedings may include fees, disbursements, expenses and remuneration." Legal Aid, New South Wales, *"Adverse Costs Order," available at* http://www.legalaid.nsw.gov.au/for-lawyers/policyonline/glossary/adverse-costs-order (last visited Sept. 27, 2011).

35. *Federal Court of Australia Act 1976* (Cth) §43(1A), *available at* http://www.comlau.gov.au; *Supreme Court Act 1986* (Vic) §33ZD, *available at* http://www.austlii.edu.au/au/legis/vic/consol_act/sca1986183/s33zd.html.

36. Legg & Travers, *Necessity Is the Mother of Invention*, *supra* note 32, at 253.

37. *Id.*

38. *Id.* at 252; Legal Profession Act 2004 (NSW) §325, *available at* http://www.legislation.nsw.gov.au; Legal Profession Act 2004 (Vic) §3.4.29, *available at* http://www.legislation.vic.gov.au.

39. Under a "no win no fee" arrangement, an attorney only earns a fee if the plaintiff is successful at litigation. *See infra* note 40.

40. *See, e.g., Legal Profession Act 2004*, (NSW), *supra* note 38, at §323-324; (providing for conditional costs agreements that may involve uplift fees); *Legal Profession Act 2004*, (Vic), *supra* note 38, at §3.4.27-3.4.28; Johnson Tiles Pty Ltd v. Esso Australia Ltd, (1999) 94 FCR 167, 173-75 ¶¶ 27-31 (discussing a costs agreement for a group action in which a group member is only liable for his/her own costs if individual claim is successful); Cook v. Pasminco Ltd, (No. 2) (2000) 107 FCR 44, 53 ¶ 52 (noting an agreement provided that "if the client lost the case the Solicitors would not be entitled to charge the client fees").

commencing legal proceedings because a plaintiff cannot afford to pay his or her own legal costs.[41] The availability of a "no win no fee" cost arrangement will depend on a lawyer's assessment of the risk of the proceedings and ability to bear non-payment for the period of the litigation. However, the "no win no fee" cost arrangement does not address the disincentive associated with an adverse costs order.[42]

Litigation funding covers a plaintiff's own legal costs and the risk of a plaintiff being liable for an adverse costs order.[43] Moreover, litigation funders are not inhibited by the prohibition on contingency fees that applies to lawyers.[44]

C. *Typical Funding Arrangements*

In a typical litigation funding arrangement, the funder (usually a commercial entity) will enter into an agreement with one or more potential litigants.[45] The funder pays the costs of the litigation (such as the lawyer's fees, disbursements, project management and claim investigation costs) and usually accepts the risk of paying the other party's costs if the claim fails through providing the plaintiff with an indemnity.[46] In return, if the claim is successful the funder will receive a certain percentage of any funds recovered by the litigants, either by way of settlement or judgment, and the litigants will assign the funder the benefit of any costs order they receive.[47] The share of the proceeds is agreed upon with the litigants, and is typically between one-third and two-thirds of the proceeds (usually after reimbursement of costs).[48]

For a litigation funder to determine whether to fund an action, the funder must calculate the risk associated with the litigation; that is, the prospects of

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41. *See supra* notes 32-37 and accompanying text (discussing the rule on costs).

42. *See* Legg & Travers, *Necessity Is the Mother of Invention*, *supra* note 32, at 253 ("The Australian approach to costs therefore dissuades unmeritorious litigation to the extent that the risk of paying the other side's legal costs creates a financial disincentive to commence the litigation.").

43. *Id.* at 254.

44. *See supra* note 38 and accompanying text (discussing the prohibition on contingency fees).

45. Legg & Travers, *Necessity Is the Mother of Invention*, *supra* note 32, at 254; Carman Yung, *Litigation funding: Officious intermeddling or access to justice?,* 15 JOURNAL OF JUDICIAL ADMINISTRATION 61, 62 (2005) (quoting *Keelhall Pty Ltd v. IGA Distribution Pty Ltd,* (2003) 54 ATR 75, 77; *Clairs Keely v. Treacy,* (2003) 28 WAR 139, 171).

46. Legg & Travers, *Necessity Is the Mother of Invention*, *supra* note 32, at 254; Yung, *supra* note 45, at 62.

47. Legg & Travers, *Necessity Is the Mother of Invention*, *supra* note 32, at 253. *See also* Yung, *supra* note 45, at 62.

48. Legg & Travers, *Necessity Is the Mother of Invention*, *supra* note 32, at 254. *See also* Vicki Waye, *Conflicts of Interests Between Claimholders, Lawyers and Litigation Entrepreneurs,* 19 BOND L. REV. 225, 297 (2007), *available at* http://epublications.bond.edu.au/blr/vol191/9; Jeffery & Katauskas Pty Limited v. SST Consulting Pty Ltd, (2009) 239 CLR 75, 86 ¶ 1, 87-88 ¶¶ 7-8, for an example of a litigation funding arrangement that did not include an indemnity for adverse costs.

success.[49] The funder must also quantify the amount of a successful recovery and the potential liability for the costs of the proceedings (the expenses incurred bringing the suit and the risk of paying the defendant's costs if the action fails).[50] In simple terms, litigation funders will fund litigation when the probability of a successful outcome multiplied by the amount they stand to recover is greater than the probability of an unsuccessful outcome multiplied by the costs the funders are liable for.[51] Ideally, the percentage of the recovery going to the funder should reflect the risk inherent in the proceedings.[52] The riskier the proceedings are, the greater the share of the proceeds that will need to be payable to the funder to make the investment attractive.[53] However, the litigation funder is able to spread the risk associated with a particular proceeding by adopting a portfolio approach to its inventory of cases.[54] If the funder is going to fund a claim involving novel theories of liability and, therefore, take a greater risk, it can offset the risk by also funding a low-risk case where liability is clear.[55] In summary, litigation funding is a business which decides whether to fund cases based on risk and return.[56]

Litigation funding does not just make available the financing needed for identifying and prosecuting potential law suits.[57] For example, central to class action litigation is the entrepreneur who can identify the potential law suit, undertake the due diligence to determine the feasibility of litigation, organize a representative party and group members, provide financing to fund the costs that

49. Michael Legg, *Reconciling Litigation Funding and the Opt Out Group Definition in Federal Court of Australia Class Actions: The Need for a Legislative Common Fund Approach*, 30 CIVIL JUSTICE QUARTERLY 52, 56 (2011) [hereinafter Legg, *Reconciling Litigation Funding*]. *See also* John Walker *et. al.*, *Funding Criteria for Class Actions*, *available at* http://www.imf.com.au/pdf/FundingCriteriaforClassActions.pdf (last visited Sept. 27, 2011).

50. Legg, *Reconciling Litigation Funding, supra* note 49, at 56.

51. *See supra* notes 49-50 and accompanying text.

52. *See Movitor Pty Ltd (in liq),*64 FCR at 393 ("[I]f the business of providing financial support for litigation by others is conducted by reputable organisations who compete with each other for that business, the fees charged by them for the provision of such assistance are likely to be kept to a level which will truly reflect the risk that the particular litigation being assisted may fail and so will provide for no more than a reasonable commercial profit.").

53. *See id.*

54. *See infra* note 55-56 and accompanying text. A portfolio approach means that it is not enough to look at the expected risk and return of one particular investment. *See* EDNA CAREW, THE LANGUAGE OF MONEY 257 (3d ed. 1996) (defining "portfolio"). Investors can reduce their exposure to individual asset risk by holding a diversified portfolio of assets. *See id.* (same). Colloquially, this is described as not "putting all of your eggs in one basket." *See id.* (same)

55. *See* Christopher Webb, *A Man Named Sue*, THE SUNDAY AGE, Sep. 17, 2006, at 17 (noting that IMF's caseload "rang[ed] from tiddlers as low as $2 million to a $190 million claim against Aristocrat, the poker machine company that is being sued for an alleged breach of the stock exchanges continuous disclosure requirements.").

56. *See id.*; Patrick Coope, *Litigation Funding* (Paper Presented at The Australian Institute of Judicial Administration Conference - Affordable Justice, Adelaide, Sept. 15-17, 2006) at 5, *available at* http://www.aija.org.au/ac06/Coope.pdf ("Our sole focus is to generate the best possible rate of return on our capital.").

57. Legg, *Shareholder Class Actions*, *supra* note 2, at 707.

are incurred, and coordinate the resources needed to achieve a favourable settlement or judgment.[58] The litigation funder frequently performs this role, although the funder may be assisted by the lawyers for the representative party.[59]

At present in Australia, litigation funders tend to use two distinct business models.[60] The first is to be a company incorporated in Australia that obtains the funds to be invested in litigation from debt and equity sources.[61] Under this model, the company is listed on a stock exchange and will comply with prospectus requirements in obtaining equity and the usual requirements for listed public corporations such as continuous disclosure obligations.[62] The second model involves the funder sourcing funds from Australian and/or overseas high-wealth individuals or corporations.[63] The second model is more opaque and in some instances may operate off-shore to take advantage of favorable tax regimes.[64] The interaction between investors and litigation funders has generally not attracted a great deal of attention, as compared to the interaction between the funder and the litigant receiving the funding (including group members in class actions) that is discussed further below.[65]

III. PRECEDENT DEVELOPMENT TO ASSIST LITIGATION FUNDING

Litigation funders, as repeat players in the litigation arena, have set about advocating changes to the laws that promote their business model.[66]

A. Campbells Cash and Carry Pty Limited v Fostif Pty Ltd - Legitimacy Gained[67]

In *Campbells Cash and Carry Pty Limited v Fostif Pty Ltd,*[68] Australia's highest court considered the legality of litigation funding for the first time.[69] The

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58. *Id.*
59. *Id.*
60. Michael Legg, *et al., Litigation Funding in Australia*, *available at* http://www.legalfund.com.au/publications/Litigation%20Funding%20Australia.pdf (previously presented by Michael Legg at the Law Society of New South Wales Young Lawyers' 2010 Annual Civil Litigation One Day Seminar, Mar. 13, 2010, Hilton Hotel, Sydney).
61. *Id.*
62. *Id.*
63. *Id.*
64. *Id.*
65. *Id.*
66. IMF (Australia) Ltd, *2008 Annual Report* (2008), at 6, *available at* http://www.imf.com.au/pdf/AnnualReport2008.pdf [hereinafter IMF, *2008 Annual Report*] (referring to its 2008 record profit being the result of, inter alia, "many years of patient precedent creation.").
67. Portions of this section are taken from an article written by Professor Michael Legg and Louisa Travers. *See* Legg & Travers, *Necessity Is the Mother of Invention*, *supra* note 32.
68. *Campbells Cash and Carry Pty Ltd,* 229 CLR.
69. The High Court also considered litigation funding issues in Mobil Oil Australia Pty Ltd v. Trendlen Pty Ltd, (2006) 229 A.L.R. 51 ¶ 1, 2006 WL 2475034 (HCA) which was heard at the same time. *Mobil Oil Australia Pty,* 229 ALR at ¶ 3.

High Court held 5-2 that litigation funding was not an abuse of process or contrary to public policy.[70] The joint judgment of Justices Gummow, Hayne and Crennan, indicated that existing doctrines of abuse of process and courts' ability to protect their processes would be sufficient to deal with a funder conducting themselves in a manner "inimical to the due administration of justice."[71] The joint judgment also explained that in jurisdictions such as New South Wales, Victoria, South Australia and the Australian Capital Territory, that had abolished maintenance and champerty as crimes and torts, only public policy questions relating to the enforceability of a contract may be relevant.[72] In other words, once the legislature abolished the crimes and the torts of maintenance and champerty, these concepts cannot be used to found a challenge to proceedings that are being maintained.[73] The only relevance of maintenance and champerty is in a dispute between plaintiff and funder about the enforceability of the agreement.[74] The Court did not decide the position for the states where legislation had not abolished maintenance and champerty as crimes and torts (Western Australia, Queensland, Tasmania and the Northern Territory).[75]

Additionally, the joint judgment considered a range of factors specific to the instant litigation[76] that alone or in combination were not contrary to public policy or would not lead to an abuse of process.[77] The factors included:

- "officious intermeddling," meaning the funder is seeking out potential claimants;[78]

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70. *See Campbells Cash and Carry Pty Ltd,* 229 CLR at 389 ("Held . . . [b]y Gleeson CJ, Gummow, Kirby, Hayne and Creenan JJ, Callinan and Heydon JJ dissenting, that the representative proceedings did not constitute an abuse of process by reason of the litigation funding, and there was no reason in public policy why they should have been stayed. Gleeson CJ agreed with the reasoning of Gummow, Hayne and Creenan JJ finding that "[t]he proceedings do not constitute an abuse of process, and there was no reason in public policy why they should have been stayed." *Id.* at 407 ¶ 1 (Gleeson CJ); *see also id.* at 432-436 ¶¶ 83-95 (Gummow, Hayne and Creenan JJ). Kirby J also agreed that abuse of process did not warrant a stay in proceedings. *Id.* at 452 ¶ 149. However, Callinan and Heydon JJ dissented, finding that there was an abuse of process because " . . . proceedings . . . depended on a harnessing of the alleged wrongs of the plaintiffs and of the curial processes established to remedy alleged wrongs for the primary purpose of generating profits . . . ." *Id.* at 496 ¶ 287 (Callinan and Heydon JJ).

71. *Id.* at 435 ¶ 93 (quoting *Clairs Keeley v. Treacy,* (2004) 29 WAR 479, 502 ¶ 125). *See also* Jeffery & Katauskas Pty Limited v. SST Consulting Pty Ltd (2009) 239 CLR 75, 92 ¶¶ 26, 29-30 ("It follows that an agreement by a non-party, for reward, to pay or contribute to the costs of a party in instituting and conducting proceedings is not, of itself, an abuse of the court's processes.").

72. *Campbells Cash and Carry Pty Ltd,* 229 CLR at 432-33 ¶¶ 84-86. *See also supra* note 16 and accompanying text (noting the jurisdictions that have abolished champerty and maintenance as crimes and torts).

73. *See Campbells Cash and Carry Pty Ltd,* 229 CLR at 432-33 ¶¶ 84-86.

74. *Id.* at 433 ¶ 86.

75. *See id.*at 432 ¶ 85 ("It is neither necessary nor appropriate to decide what would be the position in those jurisdictions where maintenance and champerty may remain as torts, perhaps even crimes.").

76. *See id.*at 433 ¶ 87 (discussing the factors raised by appellants).

77. *Id.*at 433-34 ¶¶ 87-88.

78. *Id.*at 433 ¶ 87.

- the degree of control that the funder has over the proceedings with the claimants' interests "subservient" to the funder's interests;[79] and
- the funder "bought rights to litigate and did so with a view to profit."[80] The appellant argued that the funder was "'a speculative investor in other persons' litigation.'"[81]

The joint judgment also rejected the need for special rules to protect against the risk of "blackmail settlements" in class actions as occurred in the United States.[82]

B. Sons of Gwalia v Margaretic - Viability of Shareholder Claims Against Corporations in External Administration[83]

The decision of the High Court in *Sons of Gwalia Ltd v. Margaretic*[84] signified an opening of opportunities for the litigation funding sector. Aggrieved shareholders could make certain compensation claims against a company in voluntary administration or liquidation without having to stand at the end of the queue, thereby increasing the likelihood of recovery and the utility of pursuing claims with the assistance of litigation funding.[85]

Background

Shortly after Luka Margaretic (Margaretic) bought shares in Sons of Gwalia Ltd (Sons of Gwalia), a publicly listed gold mining company, administrators were appointed to the company and the shares that were acquired appeared to be worthless.[86] Margaretic alleged that, in breach of the Australian Securities Exchange (ASX) listing rules, Sons of Gwalia "failed to notify the ASX that its gold reserves were insufficient to meet its gold delivery contracts and that it could not continue as a going concern."[87] Accordingly, he pursued a compensation claim[88] arising from violations of section 52 of the *Trade*

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79. *Campbells Cash and Carry Pty Ltd,* 229 CLR at 433 ¶ 87. That the funder retained a solicitor for the claimants did not "lessen [the funder's] control" but instead "[gave] rise to possible conflicts of duty . . . ." *Id.*

80. *Id.*

81. *Id.*

82. *Id.* at 435 ¶¶ 94-95.

83. Portions of this section are taken from Michael Legg & Ronald Schaffer, *Sons of Gwalia v. Margaretic: Encouraging Shareholder Claims and the Fraud on the Market Theory*, 35 AUSTRALIAN BUSINESS L. REV. 390 (2007).

84. Sons of Gwalia Ltd v. Margaretic (2007) 231 CLR 160.

85. *See* Corporations and Markets Advisory Committee Report, *Shareholder Claims Against Insolvent Companies - Implications of the* Sons of Gwalia *decision*, Dec. 2008, 5, *available at* http://www.camac.gov.au/camac/camac.nsf/byHeadline/PDFFinal+Reports+2009/$file/Sons_of_Gwalia_Report.pdf[hereinafter CAMAC Report] (discussing the High Court's decision in *Sons of Gwalia*).

86. *Sons of Gwalia Ltd,* 231 CLR at 176 ¶ 8.

87. *Id.*

88. Under a compensation claim a plaintiff seeks "the difference between the cost of his shares and their value . . . ." *Id.*

Practices Act 1974 (Cth), section 1041H of the *Corporations Act 2001 (Cth)* and section 12DA of the *Australian Securities and Investments Commission Act 2001 (Cth)*.[89]

Shareholder claims

The pre-*Sons of Gwalia* orthodox position was that all claims by shareholders against the company of which they are shareholders were claims in their capacity as members, and thus, they ranked last in a voluntary administration or liquidation behind all unsecured creditors.[90] Section 563A of the Corporations Act provided that:

> Payments of a debt owed by a company to a person in the person's capacity as a member of the company, whether by way of dividends, profits or otherwise, is to be postponed until all debts owed to, or claims made by, persons otherwise than as members of the company have been satisfied.[91]

Essentially, section 563A subordinated any claims made by a person in the capacity as a member of the company, whether by way of dividends, profits or otherwise, below the claims of other unsecured creditors against the company.[92] The key issue in *Sons of Gwalia* was to determine which shareholder claims in an external administration fall within or outside section 563A.[93]

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89. *Id. See also Trade Practices Act 1974* (Cth) § 52, *available at* http://www.comlaw.gov.au (providing that "[a] corporation shall not, in trade or commerce, engage in conduct that is misleading or deceptive or is likely to mislead or deceive."); *Corporations Act 2001, supra* note 19. at §1041H (prohibiting misleading or deceptive conduct in relation to financial products or services); *Australian Securities and Investments Commission Act 2001* (Cth) §12DA (same).

90. CAMAC Report, *supra* note 85, at 1, 20. *See also Sons of Gwalia Ltd,* 231 CLR at 214-15 ¶ 137.

91. *Sons of Gwalia Ltd,* 231 CLR at 174 ¶ 1 (citing *Corporations Act 2001* (Cth) §563A). However, section 563A has been amended and now provides that "[t]he payment of a subordinate claim against a company is to be postponed until all other debts payable by, and claims against, the company are satisfied." *Corporations Act 2001, supra* note 19, at§563A; *see also 2010 Corporate Insolvency Reforms*, 2010 Insolvency Reform Package, 1, *available at* http://www.treasury.gov.au/documents/1713/PDF/2010_Insolvency_Reforms.pdf (noting that the government intended to amend the Corporations Act to essentially reverse the High Court's holding in *Sons of Gwalia*).

92. *See Sons of Gwalia Ltd,* 231 CLR at 176 ¶ 6 (discussing section 563A of the *Corporations Act of 2001*).

93. CAMAC Report, *supra* note 85, at 19; *see also Sons of Gwalia Ltd,* 231 CLR at 174 ¶ 1 ("These appeals raise an issue concerning the subordination of what are sometimes called 'shareholder claims' to claims of other creditors in the application of the insolvency provision of the Corporations Act 2001 . . . . The resolution of the issue turns upon the meaning and effect of [section] 563 of the [Corporations] Act . . . .").

Claims within and outside section 563A

Those claims that fall within section 563A involve a connection between the company's obligation and the shareholder-claimant's membership, often in relation to dividend, capital repayment or other rights arising from membership of the company.[94] Falling outside of section 563A are claims arising from "investor protection legislation"[95] and not membership rights.[96]

In *Sons of Gwalia*, the claims concerned were not made by the shareholders in their capacity as members, but instead as persons buying or subscribing for shares relying upon misleading or deceptive information or material non-disclosures.[97] Such persons are entitled to the rights and protections under statutory investor protection provisions, which are not restricted to members.[98] Where a shareholder is induced to acquire shares in a company as a result of actionable misconduct (tortious or statutory) and the company subsequently goes into voluntary administration or liquidation, the shareholder is able to prove his or her debt ahead of ordinary members of the company as a judgment creditor and not in the capacity as a member.[99] Such a claim lies outside section 563A because it does not relate to the recovery of any paid-up capital, the avoidance of any liability to make a contribution to the company's capital, or the rights or obligations linked to membership of the company.[100]

Impact of decision on litigation funding

The High Court's decision establishes that section 563A is not about ". . . a 'creditors come first, shareholders come last' approach. . . ."[101] Although this decision may promote the utility of pursuing aggrieved shareholder claims, the cost of participating in the insolvency process and the cost of potential litigation, including adverse costs orders, can be disincentives.[102] It may be more economically viable for shareholders to participate in a group with litigation funding support because this allows the cost of bringing the action to be spread

94. *Sons of Gwalia Ltd,* 231 CLR at 230-235 ¶¶ 191-206.
95. CAMAC Report, *supra* note 85, at 6.
96. *Id.* at 21
97. *See Sons of Gwalia Ltd,* 231 CLR at176 ¶ 8; CAMAC Report, *supra* note 85, at 3-4.
98. CAMAC Report, *supra* note 85, at 22.
99. *Id.* at 21-22.
100. *See id.* at 20 (noting that ". . . shareholder claims that come within [section] 563A are those where there is a connection between the company's obligation and the claimant's membership. This connection is founded on the rights shareholders obtain or the obligations they incur as members under the Corporations Act, including those given by constituent documents of the company. Those matters related to dividend, capital repayment or other rights arising from the person's membership of the company.")
101. *Sons of Gwalia Ltd,* 231 CLR at 181 ¶ 19 (Gleeson CJ); CAMAC Report, *supra* note 85, at 20.
102. *See* Legg & Schaffer, *supra* note 83, at 392 (stating that without the availability of a group action and "the economies of scale, some shareholders may not have participated because their costs would have been greater than their expected recovery").

across many claimants giving rise to economies of scale because as the number of group members increases, the costs increase by a lesser amount.[103] However, a corresponding decline in pro rata recovery may need to be factored into a shareholder's decision of whether to participate.[104] Shareholders may welcome the assistance of the litigation funder who can not only assist them to navigate a voluntary administration or liquidation, but also is able to provide the financial and legal resources necessary to pursue the shareholders' claims with the administrator or liquidator, including supporting litigation to challenge the rejection of a claim or the value attributed to the claim.[105]

From the litigation funder's perspective, increasing the number of claimants is beneficial because the funder takes a percentage of the total of all claims that are subject to a funding agreement; remuneration increases as the total recovery of the group increases.[106] The nature of the voluntary administration or liquidation process in requiring that a claim is filed in order to participate[107] assists litigation funders in attracting shareholder claims and increasing the chances of capturing prospective claims.[108]

Legislative intervention to reverse the effect of Sons of Gwalia

In January 2010, the Australian federal government announced its intention to abrogate the effect of the decision in *Sons of Gwalia* by introducing legislation to amend the law so that it substantially corresponds to the position as generally understood prior to the High Court's decision.[109] This amendment was also intended to remove the right of shareholder claimants to vote as unsecured creditors in insolvency proceedings, unless the Court permits otherwise.[110] Under this legislative intervention, a shareholder would no longer be able to bring "a claim under investor protection provisions on the same footing as a conventional unsecured creditor in a voluntary administration or a liquidation."[111]

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103. *Id. See also* CAMAC Report, *supra* note 85, at 43.

104. Legg & Schaffer, *supra* note 83, at 392.

105. *Id.* at 393.

106. *Id.* at 392.

107. Legg & Schaffer, *supra* note 83, at 393. This aspect of the voluntary administration or liquidation process has some similarities to an opt in or closed class style class action which prevents free-riding. *See infra* §4.2.

108. Legg & Schaffer, *supra* note 83, at 393.

109. *2010 Corporate Insolvency Reforms*, *supra* note 91, at 1; Chris Bowen, *Corporate Insolvency Law Reform Package*, Jan. 19, 2010, 1, *available at* http://ministers.treasury.gov.au/DisplayDocs.aspx?doc=pressreleases/2010/004.htm&pageID=003&min=ceba&Year=&DocType=0 [hereinafter Bowen, *Corporate Insolvency*].

110. 2010 Corporate Insolvency Reforms, *supra* note 91, at 1.

111. CAMAC Report, *supra* note 85, at 29-30. *See also 2010 Corporate Insolvency Reforms*, *supra* note 91, at 1 (The Government intends to amend the law so that it substantially corresponds to how it was generally perceived to be prior to the High Court's decision – i.e. to 'reverse' Sons of Gwalia.").

The reasons for the government intervention are summed up in the following comments in the ministerial press release announcing the proposed legislative changes:[112]

- "'Any direct benefits to aggrieved shareholders arising from non-subordination [by section 563A] are outweighed by the negative impacts on shareholders generally as a result of restrictions on access to, and increases in, the cost of debt financing for companies.'"[113]
- "'The Government also remains concerned that the Sons of Gwalia decision has the potential to further increase uncertainty and costs of (sic) associated with external administration.'" [114]

However, such a reversal could be considered as going against the direction of investor protection law (particularly in the event of insolvency) and against the reinforcement of market confidence and integrity through the promotion and enforcement of a continuous disclosure regime.[115]

The proposed intervention would have the practical effect of confining shareholder claims under investor protection provisions to actions against solvent corporations that had the financial resources to pay such claims and to persons other than the company such as directors, officers and other advisers.[116] Litigation funders would almost never support shareholder claims against an insolvent corporation as the likelihood of a sufficient return would be low.[117] Further, funders may be reluctant to support proceedings against smaller corporations where the claim value could be greater than the corporation's resources because insolvency would make such litigation futile for the shareholder and funder.[118]

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112. *See* Bowen, *Corporate Insolvency*, *supra* note 109, at 1 (discussing proposed amendment to the Corporations Act). Chris Bowen is the minister for Financial Services, Superannuation and Corporate Law. Bowen, *supra* note 109. *See also* CAMAC Report, *supra* note 85, at 29-37, 43-45 (noting how *Sons of Gwalia* impacts external administration); *Corporations Amendment (Sons of Gwalia) Bill 2010*, Revised Explanatory Memorandum, 14-15 §§ 2.7-2.8, *available at* http://parlinfo.aph.gov.au:80/parlInfo/download/legislation/ems/r4452_ems_cdcf54e7-24cd-4458-8afb-18b1e311ed2f/upload_pdf/349951rem.pdf;fileType%3Dapplication%2Fpdf (discussing problems that have arose since *Sons of Gwalia* passed including debt financing and external administration) [hereinafter *Corporations Amendment*, Revised Explanatory Memorandum].

113. Bowen, *Corporate Insolvency*, *supra* note 109, at 1.

114. *Id.*

115. *See* CAMAC Report, *supra* note 85, at 48-49 (noting that "[t]he High Court decision is consistent with the direction of investor protection law . . . [and] the need for shareholder protection may be most marked in the event of insolvency . . . ."); *Corporations Amendment*, Revised Explanatory Memorandum, *supra* note 112, at 18 (same).

116. CAMAC Report, *supra* note 85, at 62.

117. *See supra* notes 49-50 and accompanying text (noting that in deciding when to fund an action, litigation funders analyze the risk involved and anticipate potential recovery).

118. *See supra* notes 49-50 and accompanying text (same); John Walker, *Litigation Funding and Challenges in Bringing a Class Action*, UNIVERSITY OF NEW SOUTH WALES - CONTINUING LEGAL EDUCATION, Sydney, Feb. 24, 2010; Jason Harris & Michael Legg, *What price investor protection? Class Actions v. Corporate Rescue*, 17 INSOLVENCY L.J. 185, 192 (2009), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1617522.

Proposed legislative amendments

The *Corporations Amendment (Sons of Gwalia) Bill 2010*[119] was introduced before the Australian Federal Parliament to reverse the effect of the High Court's decision on the basis that:[120]

- "The decision . . . changed the well-accepted balance of risk between shareholders and unsecured creditors . . .";[121]
- "Investors make a conscious decision to invest money in a company in the hope of sharing in the company's profits . . .";[122]
- " . . . creditors are not hoping to increase their wealth by gambling on the future profitability of a company . . ."[123] and " . . . are simply owed money for work they have already done . . . ."[124]

On November 26, 2010, the Bill was passed in the Senate, and the *Corporations Amendment (Sons of Gwalia) Act 2010* (No. 150 of 2010) commenced on December 18, 2010.[125] In particular, section 563A now operates to postpone the following claims "until all other debts payable by, and claim against, the company are satisfied":[126]

(a) "a claim for a debt owed by the company to a person in the person's capacity as a member of the company (whether by way of dividends, profits or otherwise)";[127] and

(b) "any other claim that arises from buying, holding, selling or otherwise dealing in shares in the company."[128]

The amendment in paragraph (a) above would include a claim by a member for the return of capital.[129] It is the amendment embodied in paragraph (b) above which purports to reverse the effect of the High Court's decision in *Sons of Gwalia*.[130] This means that "[a]ll claims against an insolvent company arising from buying, selling, holding or otherwise dealing with a shareholding are to

119. *Corporations Amendment (Sons of Gwalia) Bill 2010*, *available at* http://parlinfo.aph.gov.au:80/parlInfo/download/legislation/bills/r4452_aspassed/toc_pdf/10200b01.pdf;fileType%3Dapplication%2Fpdf.

120. *See* Chris Bowen, *Address to Shareholder Class Action Conference*, May 4, 2010, 1-2, *available at* http://ministers.treasury.gov.au/DisplayDocs.aspx?doc=speeches/2010/ 005.htm&pageID=005&min=ceba&Year=&DocType=1 [hereinafter Bowen, *Address*].

121. *Id.* at 1.

122. *Id.*

123. *Id.*

124. *Id.* at 1-2.

125. *Corporations Amendment (Sons of Gwalia) Bill 2010*, Parliament of Australia, *available at* http://parlinfo.aph.gov.au/parlInfo/search/display/display.w3p;query=Id%3A%22legislation%2Fbillhome%2Fr4452%22.

126. *Corporations Act 2001, supra* note 19, at §563A(1).

127. *Id.* at §563A(2) (defining "subordinate claim").

128. *Id.* (defining "subordinate claim").

129. *Corporations Amendment*, Revised Explanatory Memorandum, *supra* note 112, at 8 §1.9.

130. *Id.* at 5 §1.2.

rank equally and be postponed until all other claims are paid and not rank equally with unsecured creditors after secured and priority creditors."[131]

However, although the amendments to section 563A were intended to reverse the effect of the High Court's decision in *Sons of Gwalia*, some commentators state that there appears to be some doubt about the precision with which the amendment has been drafted so as to implement the intended effect of the amendment.[132] The current formulation of the amendment only restricts claims by shareholders of a company when it is in liquidation rather than when it is in voluntary administration.[133] This is because a "debt" or "claim" referred to in section 563A means a debt or claim " . . . that is admissible to proof against the company . . . " in the context of a winding up whether in insolvency, by the Court, or voluntarily.[134]

This drafting issue is significant because the amendment in its present form appears not to prevent plans that have been designed during a voluntary administration to rehabilitate and reorganize a financially troubled company from being undermined by the complexities and delays arising from investor claims allowed by the decision in *Sons of Gwalia*.[135] Absence further legislative intervention, it is likely that the courts, and ultimately the High Court, will need to deal with the construction of section 563A to determine whether the postponement under section 563A is applicable to "subordinate claims" arising in the context of a voluntary administration.[136]

C. Multiplex Funds Management Ltd v P Dawson Nominees Pty Ltd - The Closed Class

The legislation creating group proceedings in Australia at the federal level is Pt IVA of the *Federal Court of Australia Act 1976* (Cth) ("FCA Act"), which was enacted in 1992.[137] A class action brought under this legislation usually has

131. *Id.* at 7.

132. *See, e.g.*, Hannah Low, *Error Could Render Gwalia Ineffective*, THE AUSTRALIAN FIN'L REV., Jan. 4, 2010, at 9 (discussing drafting error in the amendment).

133. Low, *supra* note 132, at 9.

134. *Corporations Act 2001, supra* note 19, at §563A(2) (defining "claim" and "debt"). *See also id.* at§553(1) (". . . all debts payable by, and all claims against, the company (present or future, certain or contingent, ascertained or sounding only in damages), being debts or claims the circumstances giving rise to which occurred before the relevant date, are admissible to proof against the company."); *id.* at § 513 (noting that §§553 and 563A "apply in relation to the winding up of a company whether in insolvency, by the Court or voluntarily . . .").

135. *Corporations Amendment*, Revised Explanatory Memorandum, *supra* note 112, at 22 §2.35.

136. *See* Low, *supra* note 132 at 9 (noting that David Cowling, a partner at Clayton Utz, stated that "the error must be addressed or judges would be forced to 'interpret the law.'").

137. *Federal Court of Australia Act 1976, Part IVA* (Cth). The only other Australian jurisdictions to enact class action legislation to date are the State of Victoria in Part 4A of the *Supreme Court Act 1986* (Vic) and the State of New South Wales in Part 10 of the *Civil Procedure Act 2005* (NSW) which generally mirror the federal legislation. For an overview of the Australian class action procedures, *see generally* Stuart Clark and Christina Harris, *Multi-Plaintiff Litigation*

three procedural hurdles to overcome:[138] complying with the requirements for commencing the proceedings in section 33C,[139] complying with the additional pleading requirements in section 33H,[140] and avoiding being discontinued pursuant to section 33N.[141]

In addition to the above requirements, class actions in the Federal Court are also characterized by a right to receive notice of a class action and to be given the opportunity to opt out of the proceedings, i.e., affirmatively exclude

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in Australia: A Comparative Perspective, 11 DUKE J. COMP & INT'L L. 289 (2001); RACHEL MULHERON, *THE CLASS ACTION IN COMMON LAW SYSTEMS* (2004); DAMIAN GRAVE AND KEN ADAMS, *CLASS ACTIONS IN AUSTRALIA* (2005); PETER CASHMAN, *CLASS ACTION LAW AND PRACTICE* (2007); Stuart Clark and Christina Harris, *Class Actions in Australia: (Still) a Work in Progress,* 31 AUSTRALIAN BAR REV. 63 (2008); Legg and Travers, *Necessity Is the Mother of Invention, supra* note 32.

138. *See Federal Court of Australia 1976* (Cth) §§33C, 33H, & 33N. *See also infra* notes 139-41 and accompanying text.

139. *Federal Court of Australia Act 1976* (Cth) §33C. Section 33C provides:
"(1) Subject to this Part, where:

> (a) 7 or more persons have claims against the same person; and
> (b) the claims of all those persons are in respect of, or arise out of, the same, similar or related circumstances; and
> (c) the claims of all those persons give rise to a substantial common issue of law or fact;

a proceeding may be commenced by one or more of those persons as representing some or all of them."

140. *Federal Court of Australia Act 1976* (Cth) §33H. Section 33H provides:
"(1) An application commencing a representative proceeding, or a document filed in support of such an application, must, in addition to any other matters required to be included:

> (a) describe or otherwise identify the group members to whom the proceeding relates; and
> (b) specify the nature of the claims made on behalf of the group members and the relief claimed; and
> (c) specify the questions of law or fact common to the claims of the group members.

(2) In describing or otherwise identifying group members for the purposes of subsection (1), it is not necessary to name, or specify the number of, the group members."

141. *Federal Court of Australia Act 1976* (Cth) §33N. Section 33N provides:
"(1) The Court may, on application by the respondent or of its own motion, order that a proceeding no longer continue under this Part where it is satisfied that it is in the interests of justice to do so because:

> (a) the costs that would be incurred if the proceeding were to continue as a representative proceeding are likely to exceed the costs that would be incurred if each group member conducted a separate proceeding; or
> (b) all the relief sought can be obtained by means of a proceeding other than a representative proceeding under this Part; or
> (c) the representative proceeding will not provide an efficient and effective means of dealing with the claims of group members; or
> (d) it is otherwise inappropriate that the claims be pursued by means of a representative proceeding."

oneself.[142] If a group member falling within the defined class does not opt out, the member is bound by the outcome of the proceedings.[143]

However, an opt in or limited group approach is favored by litigation funders because it allows the funder to require each group member to accept the terms of the funding agreement, thereby eliminating the so called "free-riders"[144] who, pursuant to an opt-out approach, are able to participate in a successful outcome without entering a funding agreement.[145] An opt in class action model may be commenced by an applicant alone or on behalf of a group but involves notices being sent to potential group members after litigation is commenced asking them to participate in the class action by giving their consent to inclusion.[146] The limited group approach involves a class action being commenced on behalf of a group specifically created for, and prior to, the commencement of the class action.[147]

Attempts to employ an opt in model were unsuccessful in *Dorajay Pty Ltd v. Aristocrat Leisure Ltd* (Aristocrat class action),[148] but the use of a "limited group" or "closed class" method of group definition was permitted by the Full Federal Court of Australia in *Multiplex Funds Management Ltd v P Dawson Nominees Pty Ltd* (Multiplex class action).[149]

In the Multiplex class action, the Applicant commenced a Part IVA Class Action against Multiplex Limited and Multiplex Funds Management Limited (together Multiplex) on behalf of about forty corporations.[150] The corporations alleged that they suffered loss as a result of the Multiplex parties' failure to disclose delays and increased costs in the construction of the Wembley Stadium in the United Kingdom.[151]

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142. *See Federal Court of Australia Act 1976* (Cth) §§33J (providing for a right to opt out), 33X(1)(a) (providing for notice of the action and notice of the right to opt out and the giving of a specified date for that right to be exercised by).

143. *Federal Court of Australia Act 1976*, §33ZB (requiring that a judgment given in a representative proceeding identify the group members affected and binds all such members unless they opted out of the proceeding pursuant to section 33J).

144. *See* JOSHUA S. GANS, ET. AL., PRINCIPLES OF MICROECONOMICS 212 (3d ed. 2005) ("A free rider is a person who receives the benefit of a good but avoids paying for it.").

145. Legg, *Reconciling Litigation*, *supra* note 49, at 60.

146. Michael Legg, *Institutional Investors and Shareholder Class Actions: The Law and Economics of Participation*, 81 AUSTRALIAN L.J. 467, 486 n.58 (2007) [hereinafter Legg, *Institutional Investors*].

147. *Id.*

148. Dorajay Pty Ltd v. Aristocrat Leisure Ltd, (2005) 147 FCR 394, 432 ¶ 136 (noting that "the proceeding cannot continue as a representative proceeding while retaining a particular firm of solicitors is a criterion of membership of the representative group").

149. Multiplex Funds Management Ltd v. P Dawson Nominees Pty Ltd, (2007) 164 FCR 275, 294-95 ¶¶ 138-44 (hereinafter Multiplex II). The Full Federal Court dismissed the appeal from *P Dawson Nominees Pty Ltd v Multiplex Ltd* (2007) 242 ALR 111 (hereinafter *Multiplex I*). Multiplex II (2007) 164 FCR 275, 300 ¶ 201.

150. *Multiplex I*, 242 ALR at ¶¶ 1, 9.

151. *Id.* at ¶¶ 7-9.

The represented group was defined, inter alia, on the basis that they "had 'as at the commencement of the . . . proceeding entered a litigation funding agreement with International Litigation Funding Partners, Inc. (ILF).'"[152] The funding agreement contained provisions that the funded parties would not be liable for any fees, costs, or disbursements because the funds were to be paid by ILF.[153] However, if the proceedings were successful by way of judgment or settlement, the funded parties agreed that the sum received would be used to (a) reimburse ILF for the costs and disbursements of the action, (b) pay ILF "a not insignificant percentage" of the recovery, and (c) share the remainder among the group.[154] The funding agreement terminated if a funded party settled the claim or opted out of the proceedings, but the funded party would still be liable to apply any payment received as if the agreement was still on foot.[155]

The Respondents sought to strike out the Part IVA Class Action by relying on section 33N(1) of the FCA Act.[156] The Respondents also contended that the group definition amounted to an opt in approach contrary to the opt out nature of a Part IVA Class Action, and that the litigation funding agreement "imposed a . . . fetter upon the ability to opt out" contrary to section 33J.[157]

At first instance, Justice Finkelstein upheld the criterion which limited group membership in the Part IV Class Action against Multiplex to those who had entered into a funding agreement.[158] Multiplex appealed to the Full Federal Court composed of Justices French, Lindgren, and Jacobson.[159]

The lead decision was given by Justice Jacobson, with whom Justices French and Lindgren concurred.[160] Justice Jacobson applied the Australian rules of statutory interpretation which emphasized that "fundamental to the task is the giving of close attention to the text and structure of the language used by Parliament."[161]

Justice Jacobson interpreted the words "as representing some or all of them" in section 33C(1) to "expressly permit the representative party to commence a proceeding on behalf of less than all of the potential members of the group."[162] His Honour also stated that this construction, though sufficiently clear from the wording of section 33C(1), was reinforced by the fact that in enacting section 33C, Parliament rejected the ALRC recommendation that proceedings be

152. *Id.* at ¶ 1; *Multiplex II,* 164 FCR at 284 ¶ 44.
153. *Multiplex I,* 242 ALR at ¶ 31.
154. *Id.*at ¶ 32; *Multiplex II,* 164 FCR at 286 ¶ 68.
155. *Multiplex I,* 242 ALR at ¶ 33.
156. *Id.* at ¶ 35; *Multiplex II*, 164 FCR at 284 ¶ 47-48.
157. *Multiplex II*, 164 FCR at ¶¶ 45-46.
158. *Multiplex I,* 242 ALR at ¶¶ 63-65.
159. *See Multiplex II,* 164 FCR at 277, 283 ¶¶ 1-2, 39
160. *See id.* at 283 ¶¶ 1-2, 39.
161. *Id.* at 292 ¶ 119.
162. *Id.*at 281 ¶¶ 110-111. For a critique of the Full Federal Court's statutory construction, see Michael Legg, *Funding a Class Acton through Limiting the Group: What Does Part IVA of the Federal Court of Australia Act 1976 (Cth) Permit?,* 33 AUSTRALIAN BAR REV. 17 (2010).

brought on behalf of all group members.[163] However, His Honour accepted that Parliament would not have considered how, or if, a Part IVA Class Action could be structured by reference to a group of people who had taken the step of instructing a certain solicitor or signing a funding agreement with a named funder.[164] The relatively new concept of litigation funding that was approved by the High Court in 2006 was not considered by the ALRC or Parliament in devising a class action procedure that was enacted in 1991.[165] Justice Lindgren went further and stated that it would be "unsafe to rely on the class action landscape as envisaged by the ALRC in 1988" to construe Part IVA of the FCA Act.[166]

Justice Jacobson considered the group definition in the Aristocrat class action and found that it impermissibly defined the group by reference to persons who retained MBC both before and after the commencement of the relevant proceeding.[167] Individuals were able to take a positive step that would enable them to become part of (i.e. opt in) representative proceedings already on foot.[168] A group definition framed that way was inconsistent with one or more sections of Part IVA (for example, section 33J(2)), and therefore, would not be permissible.[169] This, Justice Jacobson observed, was quite different from the Multiplex class action group definition, which limited the group at the time the proceedings were commenced.[170] As such, in the Multiplex class action, there was no possibility of an individual opting in to existing proceedings.[171] However, it was noted that MBC was "looking for further investor claimants" and an application may be made to join further persons to the proceedings or initiate additional proceedings in respect of the same claims.[172]

Justice Jacobson also considered the disincentives to opting out of the proceedings created by the terms of the litigation funding agreement.[173] His

163. *Multiplex II,* 164 FCR at 291 ¶¶ 108-111. *See also id.* at 278-79 ¶¶ 9-10 (Lindgren J) (noting that these words "show positively an intention that there was to be no right of complaint merely because some of the persons . . . had been omitted from the group as defined").

164. *Id.* at 291-292 ¶¶ 112-117.

165. *See id.* at 292 ¶ 113 ("There is nothing to suggest that this phenomenon [of litigation funding] was considered by the ALRC in recommending Pt IVA or by Parliament in enacting it.")

166. *Id.* at 279 ¶ 12.

167. *Id.* at 297 ¶¶ 167-168.

168. *See Multiplex II,* 164 FCR at 297 ¶ 168 (noting that group members could retain MBC after the proceedings had commenced).

169. *Id.* at 295 ¶ 142.

170. *Id.* at 295 ¶¶ 142-143.

171. *Id.*

172. *Id.*at 288 ¶¶ 83-84; *Multiplex I*, 242 ALR at ¶ 55.

173. *See Multiplex II,*164 FCR at 295 ¶¶ 147-149 (noting that after a group member opts out, the member "remains liable to pay the 'Resolution Sum' to MBC, the costs and disbursements of the proceeding and ILF's 'not insignificant' percentage of fee are payable out of that sum").

Honour accepted that disincentives existed but found that the right to opt out was still maintained so that section 33N was not enlivened.[174]

While Justice Jacobson concluded that a representative proceeding commenced on behalf of a limited group of aggrieved individuals is permitted, his Honour observed that defining a group by reference to persons who have signed a litigation funding agreement is not easily reconciled with the overall aim of representative proceedings, being increased "access to justice and judicial efficiency in the form of a common binding decision for the benefit of all aggrieved persons."[175]

IV. COURT REGULATION OF LITIGATION FUNDING

Litigation funding has been argued to be an important and legitimate development that provides access to justice and can improve the efficiency of litigation by bringing commercial considerations to bear.[176] There can, however, be a negative aspect of litigation funding that undermines its integrity - when it allows the funder to support litigation where the funder stands to reap substantial benefits but "without . . . assuming one of the central risks ordinarily attending litigation: the risk of having to meet an adverse costs order."[177] Consequently, litigation funding may give rise to incursions upon the administration of justice "where successful defence of an action will come at a considerable cost to the defendant."[178]

A. Order for costs against a non-party

The High Court's decision in *Jeffery and Katauskas Pty Limited v. Rickard Constructions Pty Limited* (Jeffery) referred to the " . . . need to revisit . . . the principles governing security for costs . . ."[179] to address the way the risks and burdens of litigation are borne by defendants.[180] This was in circumstances in which rule 42.3 of the *Uniform Civil Procedure Rules 2005*[181] in New South Wales precluded a defendant from seeking a costs order against a non-party such as a litigation funder, where the funder did not indemnify the plaintiff against the

174. *Id.*at 295 ¶¶ 145-150. *See also id.* at 280 ¶¶ 19-20 (Lindgren J) ("There will almost inevitably always be some disincentive for a group member to opt out, at least once the proceeding has advanced.").

175. *Id.*at 292 ¶ 117. *See also id.*at 294 ¶ 137 (noting that allowing one to be a group member when one does not sign the funding agreement is contrary to providing "access to justice").

176. *See supra* note 2 and accompanying text (noting the importance of a plaintiff's "access to justice").

177. *Jeffery & Katauskas Pty Limited*, 239 CLR at 98 ¶ 40.

178. *Id.* at 97 ¶ 39. *See also* Robert Baxt, *Litigation Funding: Crossing the "Cross Roads,"* 28 COMPANIES AND SECURITIES L.J. 54, 55 (2010).

179. *Jeffery & Katauskas Pty Limited,* 239 CLR at 97 ¶ 39.

180. *Id.*

181. *Uniform Civil Procedure Rules (Amendment No 32) 2010* (NSW), *available at* http://www.legislation.nsw.gov.au/sessionalview/sessional/sr/2010-172.pdf.

defendant's costs unless one of the specified circumstances in rule 42.3(2) could be satisfied including whether there was an abuse of process.[182] Although the court generally has the power and discretion under section 98 of the *Civil Procedure Act 2005* (NSW) to make a costs order against a non-party, that discretion was expressly fettered by rule 42.3.[183]

On May 7, 2010, rule 42.3 was repealed.[184] Since then, courts' discretion under section 98 of the *Civil Procedure Act 2005 (NSW)* is unfettered and enables courts to exercise that discretion in making a costs order against a litigation funder.[185] Similarly, in the other States and in the Northern Territory, the courts have jurisdiction to make costs orders against non-parties and will only exercise the discretion to make a non-party costs order sparingly where the interests of justice allow a departure from the general rule that only parties to proceedings may be subject to costs orders.[186] The Australian Capital Territory remains the only jurisdiction where there is a specific rule of court prohibiting courts from granting a costs order against a non-party with the exception of specified circumstances.[187]

B. Jeffery & Katauskas Pty Limited v SST Consulting Pty Ltd

Initially, the court ordered costs for Jeffery & Katauskas Pty Ltd (Defendant) – on December 15, 2000, Justice Rolfe ordered $47,750 and on October 6, 2004, the second day of a nineteen-day trial, the trial judge Justice McDougall ordered $140,000.[188] However, the defendant faced a shortfall between its costs of the trial and the security provided.[189] Although the defendant was successful, it was unable to recover its costs and was left out-of-pocket in excess of $450,000.[190]

To recover the shortfall, the defendant argued that a costs award could be made against the litigation funder pursuant to the general statutory discretion under section 98 of the *Civil Procedure Act 2005 (NSW)* to order costs and rule 42.3 of the *Uniform Civil Procedure Rules 2005 (NSW)* which at that time provided for specified circumstances in which costs may be ordered against non-parties.[191] The defendant argued that there was an abuse of process where a

182. *Jeffrey & Katauskas Pty Limited,* 239 CLR at 85-86 ¶1.
183. *Id.*
184. *Uniform Civil Procedure Rules (Amendment No 32) 2010*, *supra* note 181, at 1 ¶ 6. The explanatory note accompanying these rules of court made by the Uniform Rules Committee states that "[t]he object of these Rules is to amend the *Uniform Civil Procedure Rules 2005* in relation to . . . (c) the power of the court to award costs under section 98 of the *Civil Procedure Act 2005*."
185. *See supra* note 184 and accompanying text.
186. G E DAL PONT, LAW OF COSTS, 747-50, 754-74 §§ 22.6-22.8, 22.16-22.54 (2d ed. 2009).
187. *Court Procedures Rules 2006 (ACT)* rule 1703(1).
188. *Jeffrey & Katauskas Pty Limited,* 239 CLR at 88 ¶ 10.
189. *Id.* at 89 ¶ 11.
190. *Id.*
191. *See id.* at 89 ¶¶ 1, 13 (noting that rule 42.3 " . . . does not limit the power of the court . . . to make an order for payment, by a person who has committed contempt of court or an abuse of

"non-party" litigation funder bank-rolled litigation brought "by an insolvent plaintiff but without providing the plaintiff with an indemnity against cost orders in favour of a successful defendant."[192] However, the High Court found there was no abuse of process and that at that time the Supreme Court of New South Wales did not have the power to make a costs order against the litigation funder in such circumstances.[193]

The majority suggested that the defendant could have prevented the shortfall and protected its interests by relying upon the "provisions and principles that govern security for costs."[194] Security for costs is a potential method of preventing defendants from being out-of-pocket in funded litigation.[195]

C. Relevant Principles for Security for Costs

What is the rationale of security for costs?

The purpose of a security for costs order is to protect the defendant's entitlement to recover legal costs from an unsuccessful plaintiff consistently with the general rule that "costs follow the event."[196] This rule means that a successful party receives costs as determined by the courts in the absence of special circumstances to depart from that entitlement.[197] Security for costs ensures that the orders of the court as to costs are not frustrated.[198]

Discretion to order security for costs

The courts have a broad and unfettered discretion to order security for costs.[199] Because of this, the question arises as to whether it would be

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process of the court, of the whole or any part of the costs of a party to proceedings occasioned by the contempt or abuse of process . . .").

192. *Id.* at 90 ¶ 17.

193. *Id.* at 94, 98-99 ¶¶ 29-30, 43.

194. *Jeffery & Katauskas Pty Limited,* 239 CLR at 97 ¶¶ 38-40.

195. *See infra* § 4.3 (discussing security for costs).

196. *See* Idoport v. National Australia Bank (No. 35), (2001) NSWSC 744 ¶¶ 33, 52 (noting that an adverse costs order is compensatory in nature and is protective of the efficacy of courts); DAL PONT, *supra* note 186, at 940 §28.3 ("An order for security for costs is designed to secure the defendant's to recover *its own legal costs* from an unsuccessful plantiff.").

197. *See* DAL PONT, *supra* note 186, at 939-40 §28.3 ("In cases where the court does not order costs against an unsuccessful plaintiff, whether in the exercise of its curial discretion or pursuant to a statutory direction to this end, the rationale for an order for security for costs evaporates because the successful defendant has no entitlement to any indemnity for its own costs from the plaintiff.").

198. DAL PONT, *supra* note 186, at 939-40 §28.2.

199. DAL PONT, *supra* note 186, at 982 §29.2; Fiduciary Ltd v. Morningstar Research Pty Ltd, (2004) NSWSC 664 ¶ 35. *See also infra* notes 200-212 (discussing the court's broad discretion to order costs); Green (as liquidator of Arimco Mining Pty Ltd) v. CGU Ins. Ltd, (2008) 67 ACSR 105 ¶ 7 ("The Court's discretion to require the provision of security for costs is broad and the factors informing the exercise of that discretion cannot be stated exhaustively . . .") (hereinafter Green v. CGU).

appropriate to exercise the broad discretion in circumstances where there are persons who stand behind an impecunious or insolvent plaintiff and whose primary objective is to take the benefit from the success of the litigation without assuming the attendant risks and burdens (including, in particular, a potential adverse costs order).[200]

There are several guiding principles that inform the exercise of the broad discretion:[201]

- The discretion should be exercised judiciously without any predisposition in favor of the award of security, having due regard and attributing weight to all relevant circumstances according to their intrinsic persuasiveness and the impact of other circumstances to be weighed.[202]
- Poverty will not prevent a person from litigating to secure legal rights, but a corporate plaintiff may need to render security for costs.[203]
- Applications for security of costs should be brought promptly.[204]

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200. *Green v. CGU* (2008) 67 ACSR at 105 ¶ 7.

201. *See infra* notes 202-212 and accompanying text. *See also Federal Court of Australia Act 1976* (Cth) §56, *available at* http://www.austlii.edu.au/au/legis/cth/consol_act/fcoaa1976249/s56.html (providing that the judges may order for security of costs); *Federal Court Rules 2011,* r19.02, *available at* http://www.austlii.edu.au/au/legis/cth/num_reg/fcr2011n134o2011269/s19.02.html (providing that criteria that a court may consider when ordering security for costs), rule 19.01(1), *available at* http://www.austlii.edu.au/au/legis/cth/num_reg/fcr2011n134o2011269/s19.01.html (providing that when a court orders costs it may stay the proceeding until costs are paid or dismiss a claim if the party does not pay the costs); *Corporations Act 2001, supra* note 19, at §1335(1) ("Where a corporation is plaintiff in any action or other legal proceeding, the court having jurisdiction in the matter may, if it appears by credible testimony that there is reason to believe that the corporation will be unable to pay the costs of the defendant if successful in his, her or its defence, require sufficient security to be given for those costs and stay all proceedings until the security is given."); *Uniform Civil Procedure Rules 2005,* (NSW) rule 42.21(1) (providing criteria that courts may consider when ordering security for costs); *Uniform Civil Procedure Rules 1999, (QLD)* rules 671, 674 (providing that courts may order security for costs when certain factors are present and that courts may stay or dismiss cases if security is not paid); *Supreme Court Civil Rules 2006 (SA,)* Ch 7 Pt 14 r 194 (providing factors for when security for costs may be ordered); *Supreme Court Rules 2000 (TAS),* r 828(1) (providing criteria that the court may consider when ordering security for costs); *Supreme Court (General Civil Procedure) Rules 2005 (VIC,)* r 62.02(1) (providing that courts may order security for costs in certain circumstances).

202. *See* KP Cable Investments Pty Ltd v. Meltglow Pty Ltd, (1995) 56 FCR 189, 196 ("The law is now settled that the discretion to order security for costs is unfettered and should be exercised having regard to all the circumstances of the case without any predisposition in favour of the award of security . . . ."); Jazabas Pty Ltd v. Haddad, (2007) 65 ACSR 276 ¶ 9-10, 74 (noting that the court has broad discretion); *Green v. CGU*, 67 ACSR at 105 ¶ 37-39 (discussing a court's discretion in ordering costs); DAL PONT, *supra* note 186, at 984-85, 987-88 § 29.5, 29.9-29.10 (discussing the court's discretion and how a court balances discretion).

203. *KP Cable Investments Pty Ltd,* 56 FCR at 197-98; *Jazabas Pty Ltd,* 65 ACSR at ¶ 74. *See also* DAL PONT, *supra* note 186, at 990 §29.13 ("'The general rule is that poverty is no bar to a litigant . . . .'").

204. *KP Cable Investments Pty Ltd,* 56 FCR at 197; *Jazabas Pty Ltd,* 65 ACSR at ¶ 74.

- "The strength and bona fides of the [plaintiff's] case are relevant considerations."[205]
- Security for costs should "be ordered against a party who is in substance a plaintiff, and not against parties who are defending themselves and thus forced to litigate."[206]
- In the case of an impecunious plaintiff, whether the "impecuniosity was caused by the [defendant's] conduct subject of the claim."[207]
- If the defendant's "application for security is oppressive, in the sense that it is being used merely to deny an impecunious plaintiff a right to litigate," the plaintiff could argue against a security for costs order.[208] However, the mere fact that the ordering of security will frustrate the plaintiff's rights to litigate because of its financial condition does not automatically lead to the refusal of security.[209]
- "Whether there are any persons standing behind the company who are likely to benefit from the litigation and who are willing to provide the necessary security."[210] For example, "a plaintiff company in liquidation against whom an order for security for costs is sought . . . must prove that it cannot fund the litigation from either its own resources or other resources available to it such as its shareholders or creditors."[211]
- "[W]hether persons standing behind the plaintiff company have offered any personal undertakings to meet the plaintiff's liability for an adverse costs order."[212]

D. The Nexus Between the Litigation Funder and Security for Costs

These general guiding propositions in conjunction with the rules of court and section 1335(1) of the *Corporations Act 2001* point to the possibility of exercising the broad discretion in favor of the defendant in circumstances where the litigation involves an impecunious or insolvent corporate plaintiff and is financed by a funder who has a commercial interest in the fruits of that litigation without any responsibility by way of an indemnity for the plaintiff's liability for the defendant's costs.[213] Judicial support for this possibility is to be found in *Green v CGU* where Justice Hodgson focused on matters of legal policy:

205. *KP Cable Investments Pty Ltd,*56 FCR at 197; *Jazabas Pty Ltd,* 65 ACSR at ¶ 74.
206. *KP Cable Investments Pty Ltd,* 56 FCR at 198; *Jazabas Pty Ltd,* 65 ACSR at ¶ 74.
207. *KP Cable Investments Pty Ltd,* 56 FCR at 197; *Jazabas Pty Ltd,* 65 ACSR at ¶ 74.
208. *KP Cable Investments Pty Ltd,* 56 FCR at 197; *Jazabas Pty Ltd,* 65 ACSR at ¶ 74.
209. *KP Cable Investments Pty Ltd,* 56 FCR at 197; *Jazabas Pty Ltd,*65 ACSR at ¶ 74.
210. *KP Cable Investments Pty Ltd,* 56 FCR at 197; *Jazabas Pty Ltd,* 65 ACSR at ¶ 74.
211. *KP Cable Investments Pty Ltd,* 56 FCR at 197-98; *Jazabas Pty Ltd,* 65 ACSR at ¶¶ 74, 77.
212. *KP Cable Investmements Pty Ltd,* 56 FCR at 198; *Jazabas Pty Ltd,* 65 ACSR at ¶¶ 74, 78.
213. *See Corporations Act 2001, supra* note 19, at §1335(1) (providing that "[w]here a corporation is plaintiff in any action or other legal proceeding, the court having jurisdiction in the matter may, if it appears by credible testimony that there is reason to believe that the corporation

> . . . a court should be readier to order security for costs where the non-party who stands to benefit from the proceedings is not a person interested in having rights vindicated, as would be a shareholder or creditor of a plaintiff corporation, but rather is a person whose interest is solely to make a commercial profit from funding the litigation. Although litigation funding is not against public policy, the court system is primarily there to enable rights to be vindicated rather than commercial profits to be made; and in my opinion, courts should be particularly concerned that persons whose involvement in litigation is purely for commercial profit should not avoid responsibility for costs if the litigation fails.[214]

Justice Campbell expressed similar concerns about litigation funding as a vehicle for the desire to make a commercial profit:

> One extremely relevant factor is the extent to which the litigation, if successful, will ultimately be for the private profit of the funder. That information is simply not known in the present case. The court is aware that the reported cases show a significant range of returns being asked by commercial litigation funders . . . Similarly in the present case, the very fact of private profit from the litigation, and lack of satisfaction that there are available assets from which an unfavorable costs order against the liquidator would be met, are enough to show that some order of security for costs should be made.[215]

Reward and risk should be aligned.[216] If the funder makes the litigation possible and may stand to benefit from a successful outcome, then the funder should be liable for the consequences of an unsuccessful outcome - an adverse costs order.[217] Failure to enforce this norm in relation to litigation funding means there is no deterrence to unmeritorious litigation.[218]

Security for costs in these circumstances provides a way of preventing a situation where: "[Y]ou . . . have no choice about whether to play this game; we are going to provide the means to start and continue it; if our side wins, you pay us; but if you win we will not pay you."[219] Vindication of a defendant would

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will be unable to pay the costs of the defendant if successful in his, her or its defence, require sufficient security to be given for those costs and stay all proceedings until the security is given").

214. *Green v. CGU,* 67 ACSR at 105, ¶ 51 (citing *Campbells Cash & Carry Ltd v. Fostif Pty Ltd*, 229 CLR at ¶¶ 87-95).

215. *Green v. CGU,* 67 ACSR at 105 ¶ 88.

216. Michael Legg, *Security for costs: The Solution to Litigation Funding*, THE AUSTRALIAN FIN'L REV., Nov. 13, 2009, at 42 [hereinafter Legg, *Security for costs*].

217. *Id.*

218. *Id.*

219. *Jeffery & Katauskas Pty Limited,* 239 CLR at 125 ¶ 113 (citing *Hamilton v. Al Fayed [No 2]* [2003] QB 1175, 1183 ¶ 11).

only be a pyrrhic victory if the plaintiff could not pay the defendant's costs, especially through its litigation funder.[220]

E. Policy Reasons for Requiring Litigation Funders to Provide Security for Costs

The traditional reasons for awarding security for costs are set out above, namely to protect the efficacy of the exercise of the jurisdiction to award costs and to prevent a situation where a party's success is pyrrhic. If the Australian system of costs - costs follow the event or loser pays - is to be effective, then funders should not be able to shield themselves behind impecunious plaintiffs.

Reward and risk should be aligned.[221] If the funder makes the litigation possible and may stand to benefit from a successful outcome, then the funder should be liable for the ramifications of an unsuccessful outcome - an adverse costs order.[222] Failure to enforce this norm in relation to litigation funding means there is no deterrence to unmeritorious litigation.[223] A side-effect of this is the encouraging of "strike suits" where a defendant facing a plaintiff of little means but backed by a funder may have to settle due to the prospect of substantial costs with little hope of recoupment even if successful in the defense of the proceedings.[224]

"Security for costs may also act as a form of consumer protection for the plaintiff who receives funding. The plaintiff is protected (as well as the defendant) as the security means that funds are available to pay an adverse costs order if the case is unsuccessful, so that the plaintiff is not left to foot the bill and possibly be bankrupt or wound up."[225] Security for costs prevents a funder from terminating a funding agreement when the going gets tough, thus leaving a plaintiff exposed.[226] The risk of a plaintiff being deserted by a funder and being left to pay costs orders when the proceedings are discontinued will depend upon the terms of the specific funding agreement.[227] An order to provide security for costs may mean the terms of the funding agreement do not need to be considered.[228] "However, security for costs does not completely protect consumers as it does not address the terms of the funding such as where funders

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220. *See supra* Part IV.E (discussing the policy arguments in favour of requiring litigation funders to pay for a costs order).

221. Legg, *Security for costs*, *supra* note 216, at 42.

222. *Id.*

223. Legg, *Shareholder Class Actions, supra* note 2, at 709.

224. *Id.* at 709-710.

225. Michael Legg and Edmond Park, *Litigation Funding and Security for Costs,* 47 LAW SOCIETY J. 74, 76 (2009).

226. Michael Legg, et al, *Litigation Funding in Australia*, [2010] UNSWLRS 12, *available at* http://www.austlii.edu.au/au/journals/UNSWLRS/2010/12.html.

227. *Id.*

228. *Id.*

take a percentage that is extortionate or far in excess of the risk of the litigation."[229]

Requiring a funder to provide security for costs will also improve the development of the litigation funding industry as it ensures only funders of substance can support litigation or only big funders can bring big litigation.[230] Such a requirement would also offer some protection against a funder becoming insolvent part way through litigation because the funder must have the ability to post security.[231]

Concern has been expressed that commercial litigation funders need to be distinguished from mere financial assistance from a third party, such as friends; relatives; insurance; legal aid; co-operative ventures such as trade unions, creditors and shareholders of a corporate litigant; or through retaining lawyers pursuant to a conditional costs agreement.[232] Otherwise, security may be ordered too readily. If a distinction is needed, security for costs could be limited to the profit-seeking funder who is entitled to a share of any potential recovery and has no pre-existing relationship with the plaintiff.[233] However, the rules and principles set out above provide a framework which allows a judge to weigh all the relevant circumstances and so do justice in the particular case.

F. Quantum of Security

Despite the availability of security for costs where a funder is involved, it may not be a panacea for the reasons given by Justice Heydon in the following warning on its efficacy:

> Judges are reluctant to order security for costs in large amounts, perhaps fearing that this will simply prolong the litigation in an ill-disciplined way. "The amount awarded as security is no more than an estimate of the future costs and it is not reasonable to expect a defendant to make further applications to the court at every stage when it appears that costs are escalating so as to render the amount of security previously awarded insufficient." The lack of judicial generosity is one of several signs that applications seeking security for costs have little attraction for judges. In part that is because they are interlocutory, satellite and hypothetical. Their interlocutory character is repellent to courts eager to deal with trials but hard pressed to do so. They are satellite in character because they often involve spending significant time examining complex questions of solvency which are irrelevant to the main proceedings. They are hypothetical in character because their point depends on the hypothesis, which may or may not be realised, that

229. Legg & Park, *supra* note 225, at 76.
230. Legg, *Security for Costs, supra* note 216, at 42.
231. *Id.*
232. *Green v. CGU,* 67 ACSR at 105 ¶ 67.
233. *Green v. CGU,* 67 ACSR at 105 ¶ 77.

> the defendant will succeed, so that through them stalks the fear in many instances that they are a waste of time. They generate additional costs of their own.[234]

In practice, determining the appropriate amount of the security will be critical to any application for a security for costs order. The relevant provisions in the various rules of court are couched in general language giving the courts a wide discretion to order security in such manner and form and on such terms as the courts direct.[235] The rules of court do not provide any guidance as to how much security or how the amount should be assessed. Allied to the broad discretion to grant a security for costs order, is the discretion to order "such sum as the court thinks just, having regard to all the circumstances of the case."[236]

> A proper exercise of the court's discretion should consider the likely costs that the defendant will incur so far as it can be ascertained to ensure the security is neither too much nor too little.[237] Generally, courts have adopted a conservative approach by emphasizing that the amount of the security is not intended to be a pre-estimate or a complete indemnity of the actual amount of the costs recoverable by a successful defendant.[238] However, the discretion remains unfettered and each case depends on its own facts whereby the defendant bears the onus of providing the court with as much helpful and predictive information at the earliest opportunity, including a well explained estimate of future costs that may be reasonably incurred, that takes into account the number, nature and prospects of the issues in dispute.[239] The amount of the security must be determined as accurately as possible despite the inherent contingencies of estimating all reasonable future costs of the proceedings. The security will only be as effective as its quantification.

G. Disclosure of Litigation Funding Agreements

The "*Practice Note CM 17 Representative Proceedings commenced under Part IVA of the Federal Court of Australia Act 1976*" came into effect on July 5, 2010 to supplement the provisions within Part IVA of the FCA Act and Order 73

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234. *Jeffery & Katauskas Pty Limited,* 239 CLR at ¶ 93.

235. See *Federal Court of Australia Act 1976 (Cth)* §56(2) and *Federal Court Rules 2011,* rule 19.01(1)(a); *Uniform Civil Procedure Rules 2005 (NSW),* rule 42.21(2); *Uniform Civil Procedure Rules 1999 (QLD,)* rule 673(1); *Supreme Court Civil Rules 2006 (SA,)* Pt 14 rule 194; *Supreme Court Rules 2000 (TAS),* rule 829(1); *Supreme Court (General Civil Procedure) Rules 2005 (VIC),* rule 62.03.

236. DAL PONT, *supra* note 186, at 28.32. The reference in section 1335(1) to "sufficient security" does not limit this discretion to set the amount.

237. *Id.* at 28.32-28.33.

238. *Id.* at 28.34.

239. Note § 60 of the *Civil Procedure Act 2005 (NSW)* states the "cost to the parties is proportionate to the importance and complexity of the subject-matter in dispute."; DAL PONT, *supra* note 186, at 28.34.

of the old *Federal Court Rule*s in relation to representative proceedings in the Federal Court of Australia.[240] A substantial re-write of the Federal Court Rules occurred in 2011 and the *Federal Court Rules 2011* came into effect on August 1, 2011. Order 73 was replaced by Division 9.3 of the *Federal Court Rules 2011*. Practice Note CM17 was also revised on August 1, 2011. The Supreme Court of Victoria has also published "Practice Note No 9 of 2010 – Conduct of Group Proceedings" which commenced on January 1, 2011 and is in substance the same as the Federal Court's Practice Note CM 17. Both *Practice Note CM 17* and *Practice Note No 9* state: "At or prior to the initial case management conference each party will be expected to disclose any agreement by which a litigation funder is to pay or contribute to the costs of the proceeding, any security for costs or any adverse costs order."[241]

The requirement for the disclosure of any litigation funding agreement will provide greater transparency and certainty for parties, especially a defendant/respondent, before any decision is made to apply for an order for security for costs. This will obviate the need for any order for discovery to establish the financial state of affairs of the plaintiff(s)/applicant(s) and the identity of any third party providing funding or financial support for the proceedings.

The disclosure of the funding agreement will also be relevant not only to the exercise of the court's discretion in making an order for security for costs against a litigation funder, but also if the discretion is exercised in favor of the defendant/respondent, in determining the appropriate amount of security. At the initial case management conference or thereafter, the parties should be in a position to address whether the defendant/respondent proposes to seek an order for security for costs.[242] Clause 5.1 of both *Practice Note CM 17* and *Practice Note No 9 of 2010* foreshadows a motion seeking an order that the plaintiff/applicant provide security for costs. If the plaintiff/applicant is ultimately unsuccessful in the representative proceedings, the terms of the litigation funding agreement may also be relevant to the exercise of the court's discretion in making an order for costs against the litigation funder standing behind the plaintiff/applicant.[243]

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240. *See* Practice Note CM 17, *available at* http://www.fedcourt.gov.au/pdfsrtfs_p/practice_notes_cm17.rtf.

241. Practice Note CM 17, clause 3.6; Practice Note No. 9 or 2010, clause 3.6, *available at* http://www.supremecourt.vic.gov.au/wps/wcm/connect/justlib/Supreme+Court/resources/d/7/d7e3330044dc204caa4ceb067e306f2f/No.+9+of+2010+Conduct+of+Group+Proceedings.pdf. This clause also permits the redaction of any funding agreement "to conceal information which might reasonably be expected to confer a tactical advantage on the other party."

242. Practice Note CM 17, clause 3.5(h); Practice Note No. 9 of 2010, clause 3.5(h).

243. New South Wales Law Reform Commission, *Submission of Maurice Blackburn Pty Ltd on Security for Costs and Associated Costs Orders*, Feb. 26, 2010, *available at* http://www.justice.nsw.gov.au/lawlink/lrc/ll_lrc.nsf/vwFiles/Cref126ps_Maurice_Blackburn_Lawyers.pdf/$file/Cref126ps_Maurice_Blackburn_Lawyers.pdf.

In relation to class actions in the Supreme Court of New South Wales, a number of initiatives are being considered by the New South Wales government to address the growth of the litigation funding industry in light of the existing regulatory framework in the both the Federal and Victorian court systems.[244] The initiatives under consideration include the requirement for disclosure of litigation funding arrangements to the court.[245]

H. Case Management Principles and Litigation Funders

In recent years, legislative reforms to civil practice and procedure have been introduced to expand the role of the courts in the management of the administration of justice.[246] A court must not only aim for the attainment of justice between the parties but also take into account the interests of other litigants and the public as a whole in curbing waste and inefficient use of public resources and undue cost and delay by reference to principles of judicial case management.[247] This approach to civil practice and procedure recognizes

> the important public policy in the interests of the efficient use of public and private resources and the promotion of the private interests of members of the public and the commercial community in the efficient conduct of dispute resolution in litigation, mediation and arbitration in a fair, speedy and cost efficient manner . . .[248]

Further legislative changes have extended the scope of judicial case management to encompass greater scrutiny by the courts of litigation funding arrangements and the conduct of funders in the course of civil litigation to ensure compliance with case management principles in the class-action setting.[249]

Set out below is an overview of the key provisions of the statutory case management framework in both New South Wales and Victoria.

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244. NSW Department of Justice and Attorney General, Legislation and Policy Division, *Consultation Draft Civil Procedure Amendment (Supreme Court Representative Proceedings) Bill 2010 – Discussion Paper*, Oct. 21, 2010, *available at* http://www.lawlink.nsw.gov.au/lawlink/legislation_policy/ll_lpd.nsf/vwFiles/Consultation_discussion_paper211010.pdf/$file/Consultation_discussion_paper211010.pdf.

245. *Id.*

246. Chief Justice Spigelman, *Case Management in New South Wales*, a paper prepared for the judicial delegation from India, Sept. 21, 2009, *available at* http://www.lawlink.nsw.gov.au/lawlink/Supreme_Court/ll_sc.nsf/vwFiles/spigelman210909.pdf/$file/spigelman210909.pdf.

247. Aon Risk Services Australia Limited v. Australian National University, (2009) 239 CLR 175 at ¶¶ 23-24, 30 per French CJ, at [92] per Justices Gummow, Hayne, Crennan, Kiefel and Bell.

248. United Group Rail Services Ltd v. Rail Corporation of New South Wales, (2009) NSWCA 177 at ¶ 78 per Allsop P (with whom Ipp and Macfarlan JJA agreed).

249. Chief Justice Spigelman, *supra* note 246.

Overriding purpose

Of central importance is the statutory duty that a court "must seek to give effect to the overriding purpose" when it exercises or interprets its case management powers in respect of civil proceedings.[250] The "overriding purpose" is "to facilitate the just, quick and cheap resolution of the real issues in the proceedings."[251] The overriding purpose provides the central organizing principle for judicial case management of all matters of civil practice and procedure in New South Wales and Victoria.

The legislation in New South Wales and Victoria specifies the "objects" which the court must have regard to, in ultimately furthering the overriding purpose, when it exercises or interprets its judicial case management powers.[252] The objects include:

- "the just determination of the proceedings";
- "the efficient disposal of the business of the court";
- "the efficient use of available judicial and administrative resources";
- "the timely disposal of the proceedings, and all other proceedings in the court, at a cost affordable by the respective parties";

dealing with a civil proceeding in such a way that the cost to the parties is "proportionate to the complexity or importance of the issues in dispute and the amount in dispute."[253]

Litigation funders

In Victoria, the *Civil Procedure Act 2010* extends the application of the "paramount duty"[254] to further the administration of justice (which encompasses the overarching purpose by virtue of the main purposes[255] of the Act) in relation to civil proceedings beyond the parties and their lawyers to:

> any person who provides financial assistance or other assistance to any party in so far as that person exercises any direct control, indirect control or any influence over the conduct of the civil proceeding or of a party in respect of that civil proceeding, including, but not limited to—
>
> (i) an insurer;

250. *Civil Procedure Act 2005 (NSW),* §56(2); *Civil Procedure Act 2010 (Vic),* §8(1)(a) ("whether those powers are part of the Supreme Court's inherent jurisdiction, implied jurisdiction or statutory jurisdiction").

251. *Civil Procedure Act 2005 (NSW),* §56(1); *Civil Procedure Act 2010 (Vic),* §§1(1)(c), 7(1) ("to facilitate the just, efficient, timely and cost-effective resolution of the real issues in dispute").

252. *Civil Procedure Act 2005 (NSW),* §§57(1), 57 (2), 60; *Civil Procedure Act 2010 (Vic),* §9(1).

253. *Civil Procedure Act 2005 (NSW),* §§57(1), 57(2), 60; *Civil Procedure Act 2010 (Vic),* § 9(1).

254. *Civil Procedure Act 2010 (Vic),* §16.

255. *Civil Procedure Act 2010 (Vic),* §1(1)(c).

(ii) a provider of funding or financial support, including any litigation funder.[256]

The Victorian legislation also imposes various other "overriding obligations" on parties to civil proceedings, including an obligation to ensure that their claims have a proper basis, not to mislead or deceive, and to "use reasonable endeavours to ensure that legal costs and other costs incurred in connection with the civil proceeding are reasonable and proportionate to the complexity or importance of the issues in dispute and the amount in dispute."[257]

In New South Wales the *Civil Procedure Act 2005* was amended by the *Courts and Crimes and Legislation Further Amendment Act 2010*. The following changes relate specifically to extending the application of the overarching purpose to litigation funders:

- "any person with a relevant interest in the proceedings commenced by the party" "must not, by their conduct, cause the party to be put in breach of their duty" to assist the court to further the overriding purpose;[258]
- for the purposes of section 56, "a person has a relevant interest in civil proceedings if the person:

  (a) provides financial assistance or other assistance to any party to the proceedings; and

  (b) exercises any direct or indirect control, or any influence, over the conduct of the proceedings or the conduct of a party in respect of the proceedings.

  Note. Examples of persons who may have a relevant interest are insurers and persons who fund litigation."[259]

The overarching purpose and the overriding obligations apply to litigation funders in respect to the conduct of any aspect of a civil proceeding in a court, including, but not limited to any interlocutory application, including an application for an order for security for costs or the determination of whether the court should exercise its discretion in making an order for costs.[260] When the court is required to exercise its discretion in relation to an order for security for costs or costs generally, the Victorian statute expressly provides that the paramount duty and the other overarching obligations (which are subject to the paramount duty) "prevail over any legal obligation, contractual obligation or other obligation" which the litigation funder may have under the litigation

256. *Id.* at §10(1)(d).

257. *Id.*at §§18, 21, 24.

258. *Courts and Crimes and Legislation Further Amendment Act 2010* (NSW), Schedule 6.2 item [5] (new § 56(4)).

259. *Id.* at Schedule 6.2 item [7] (new §56(6)).

260. *Civil Procedure Act 2005 (NSW),* §§56(1), 56(3), 56(5) and definition of "civil proceedings" in § 3(1); *Civil Procedure Act 2010 (Vic),* §§11(a), 16, 28(2), 29(1).

funding agreement or otherwise, "to the extent that the obligations are inconsistent."[261]

The application of case management principles to litigation funders provides an additional layer of regulation by the courts of litigation funding to ensure that the administration of justice is well served by keeping litigation funders accountable for their involvement in civil litigation in view of their interest in making a commercial profit from funding the litigation and making the funders responsible for the costs of litigation, especially if the litigation is unsuccessful.

V. FINANCIAL SERVICES REGULATION OF LITIGATION FUNDING

The Australian Standing Committee of Attorneys-General ("SCAG") examined the need for the regulation of litigation funding in 2006.[262] It appears "that the Commonwealth Minister for Financial Services, Superannuation and Corporate Law will now build upon the work done by SCAG," which may see legislative change aimed at specifying criteria for legally acceptable funding agreements, and adopting prudential regulation requirements for funders.[263] However, litigation funding tends to remain relatively unregulated, and therefore, there is some concern that funding agreements may be struck unfairly.[264] This is particularly significant because there is relatively little competition for funders and such agreements often entitle the funders to large fees in comparison to the fees charged by lawyers, which are regulated and subject to competition.[265]

A. Australian Financial Services License

A potential safeguard against litigation funders imposing unfair or extortionate terms on litigants would be to require all litigation funders to obtain an Australian Financial Services Licence ("AFSL") pursuant to Chapter 7 of the *Corporations Act 2001* (Cth), and in doing so enable the Australian Securities and Investments Commission to take on a supervisory role in relation to the conduct of the funders' businesses pursuant to their AFSLs.[266] This is a safeguard because the holder of an AFSL is required to meet the following obligations pursuant to section 912A(1) of the Corporations Act 2001 (Cth):

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261. *Civil Procedure Act 2010 (Vic),* §12.

262. Standing Committee of Attorneys-General, *Litigation Funding in Australia* (May 2006).

263. SCAG Communique, 5,6 Nov. 2009 at 2 and 6, access on Feb. 1, 2010 *available at* http://www.scag.gov.au/lawlink/SCAG/ll_scag.nsf/vwFiles/SCAG_Communiqu%C3%A9_5-6November_2009v2.pdf/$file/SCAG_Communiqu%C3%A9_5-6November_2009v2.pdf

264. Stuart Clark and Christina Harris, *The Push to Reform Class Action Procedure in Australia: Evolution or Revolution?,* 32 MELB. U. L. REV. 775, 810 (2008).

265. *Id.*

266. See IMF (Australia) Ltd, *Policy Issues in Litigation Funding* (Jan. 2009) at 12-13, *available at* http://www.imf.com.au/pdf/87086v2.pdf.

(a) do all things necessary to ensure that the financial services covered by the licence are provided efficiently, honestly and fairly; and

(aa) have in place adequate arrangements for the management of conflicts of interest that may arise wholly, or partially, in relation to activities undertaken by the licensee or a representative of the licensee in the provision of financial services as part of the financial services business of the licensee or the representative; and

(b) comply with the conditions on the licence; and

(c) comply with the financial services laws; and

(ca) take reasonable steps to ensure that its representatives comply with the financial services laws; and

(d) unless the licensee is a body regulated by APRA--have available adequate resources (including financial, technological and human resources) to provide the financial services covered by the licence and to carry out supervisory arrangements; and

(e) maintain the competence to provide those financial services; and

(f) ensure that its representatives are adequately trained, and are competent, to provide those financial services; and

(g) if those financial services are provided to persons as retail clients--have a dispute resolution system complying with subsection (2); and

(h) unless the licensee is a body regulated by APRA--have adequate risk management systems; and

(j) comply with any other obligations that are prescribed by regulations made for the purposes of this paragraph.

Although it is currently unclear whether an AFSL is necessary, certain litigation funders in Australia have already applied for, and been granted, an AFSL,[267] presumably out of an abundance of caution to ensure that the funders are not inadvertently in breach of the Corporations Act, to bolster the legitimacy of an industry subject to suspicion in some parts of the community, and/or to distinguish themselves from their competitors. Regardless of whether holding an AFSL is strictly required for their activities, as an AFSL holder these funders would still have to comply with the general requirements set out above.

The necessity for a litigation funder to hold an AFSL was considered by the New South Wales Court of Appeal in *International Litigation Partners Pte Ltd. v. Chameleon Mining NL* [2011] NSWCA 50. The case involved a dispute between Chameleon Mining NL (CHM) and International Litigation Partners Pte Ltd (the Funder), a company incorporated in Singapore, in relation to the parties' respective rights under a litigation funding agreement that had been entered into by CHM to allow it to pursue litigation in the Federal Court of Australia against

267. For example IMF (Australia) Ltd has held AFSL No. 286906 since July 4, 2005 allowing it to issue, apply for, acquire, vary or dispose of derivatives. In February 2010 the license was expanded to also cover "interests in managed investment schemes excluding investor directed portfolio services." *See* http://www.imf.com.au/pdf/AFS286906.pdf.

a third party.[268] Relevantly, CHM argued that it had a right to rescind the funding agreement pursuant to section 925A of the Corporations Act because the funding agreement was a financial product, and the Funder did not hold the necessary AFSL allowing it to issue such products.[269]

At first instance CHM argued that the funding agreement was a financial product because it was a facility through which CHM made a financial investment or managed financial risk as contemplated by sections 763A(1)(a) and (b) of the Corporations Act and "is within the specific things that are financial products described in section 764A(1), namely a derivative. . . ."[270] CHM was said to have managed the risk "by shielding itself against the possibility of incurring legal costs but failing to recover sufficiently or at all against [the other party to the relevant litigation]."[271] The trial judge did not accept this argument and held that the funding agreement was not a derivative nor was it a financial product.[272]

The Court of Appeal found that the funding agreement was prima facie a financial product under Section 763A of the Corporation Act because it was a facility through which financial risk, namely the consequences of losing the litigation including adverse costs orders, were managed.[273] A number of exemptions or carve-outs then had to be considered, however, including whether the financial product aspect of the agreement was only an incidental component or whether the component was a credit-facility. Two of the three judges of appeal (Young JA and Giles JA) found none of the possible exemptions to be applicable.[274] Hodgson JA in dissent found that "the funding of the litigation, and the provision to the funder of the chance of a very large fee constituted the main purpose of the Funding Agreement, to which risk management was subsidiary."[275] Consequently, the Funder had provided a financial product in Australia without an AFSL, and CHM was entitled to rescind the funding agreement.

It should be noted that this case only considered whether the funding agreement was a financial product on the basis of the arguments put forward by the parties. It is possible that a funding arrangement could be held to be a financial product, and consequently that the litigation funder is required to hold an AFSL, under other provisions (for example as a result of being a managed investment scheme as discussed below).

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268. Chameleon Mining NL v. Int'l Litig. Partners Pte Ltd and Others, (2010) NSWSC 972, ¶¶ 1, 20, 24.
269. *Id.* at ¶¶ 30, 36.
270. *Id.* at ¶ 74.
271. *Id.* at ¶ 75.
272. *Id.* at ¶ 78.
273. Int'l Litig. Partners Pte Ltd. v. Chameleon Mining NL (2011) 276 ALR 138 at ¶¶ [45], [122] and [209]. Justice Giles also found that the funding agreement was a derivative at ¶ [75].
274. *Id.* at ¶¶ [80], [91], [209] and [220].
275. *Id.* at ¶ [126].

The outcome of *Chameleon Mining* is inconsistent with the Australian government's stated intentions in relation to regulating the funding of class actions, namely that it intends to introduce legislative reform to "clarify that funders of class actions and class action lawyers are not subject to . . . the licensing, conduct and disclosure requirements applying to financial services in the Corporations Act."[276] This legislative reform would overturn the New South Wales Court of Appeal decision. It is also possible that the Funder will seek special leave to appeal to the High Court of Australia.

B. Litigation Funding as a Managed Investment Scheme

In *Brookfield Multiplex Limited v International Litigation Funding Partners Pte Ltd* (2009) 180 FCR 11; [2009] FCAFC 147 ("Brookfield Multiplex") the Federal Court considered whether certain litigation funding arrangements constituted a "managed investment scheme" as defined by section 9 of the Corporations Act 2001 (Cth) (MIS).[277]

To briefly restate the facts, several groups of investors brought a representative action against Multiplex based primarily on contravention of the continuous disclosure obligations in the Corporations Act.[278] The investors engaged Maurice Blackburn (MBC) to act on their behalf with funding coming from International Litigation Funding partners (Funder).[279] The defendant, Multiplex, alleged that the various arrangements between the group members, MBC and Funder constituted a managed investment scheme which was not registered under the Corporations Act.[280] Accordingly, Multiplex sought declaratory relief and injunctions that would prevent the group members, MBC and the Funder from taking any steps to further their arrangements, and effectively bring the litigation to a stand-still.[281]

At first instance the primary judge, Justice Finkelstein, found that the litigation funding arrangements did not constitute a MIS.[282] This decision was

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276. Address by the Hon. Chris Bowen, Minister for Financial Services, Superannuation and Corporations Law to Shareholder Class Action Conference, Quay Grand Suites, Sydney, May 4, 2010, *available at* http://ministers.treasury.gov.au/DisplayDocs.aspx.

277. This case arose as part of the Multiplex class action discussed at 4.2 above which was a tenaciously fought dispute involving about 46 interlocutory hearings and multiple appeals that ultimately settled for $110 million. *See* Bernard Murphy and Andrew Watson, Negotiation and Settlement - 2010 Multiplex Debrief, *Shareholder Class Action Masterclass*, Sydney, Oct. 18, 2010; *see also* P Dawson Nominees Pty Ltd v. Brookfield Multiplex Ltd (No 4) [2010] FCA 1029.

278. Brookfield Multiplex Ltd. v. Int'l Litigation Funding Partners Pte Ltd. (No 3) (2009) FCA 450 at ¶ 1.

279. Brookfield Multiplex Ltd. v. International Litigation Funding Partners Pte Ltd. (2009) 180 FCR 11 at ¶ 42.

280. *Brookfield Multiplex Ltd. (No. 3),* FCA 450 at ¶ 2.

281. *Id.*

282. *Id.* at ¶¶ 37-43.

reversed by a majority of the Full Federal Court (Justices Sundberg and Dowsett, Justice Jacobson dissenting).[283]

Both judgments focused on the precise wording of section 9(a) of the Corporations Act. The section provides that:

> "managed investment scheme" means "a scheme that has the following features:
>
> (i) people contribute money or money's worth as consideration to acquire rights (interests) to benefits produced by the scheme (whether the rights are actual, prospective or contingent and whether they are enforceable or not);
>
> (ii) any of the contributions are to be pooled; or used in a common enterprise, to produce financial benefits, or benefits consisting of rights or interests in property, for the people (the members) who hold interests in the scheme (whether as contributors to the scheme or as people who have acquired interests from holders); and
>
> (iii) the members do not have day-to-day control over the operation of the scheme (whether or not they have the right to be consulted or to give directions."[284]

Relevantly, section 9 also contains the following definition: "'interest' in a managed investment scheme means a right to benefits produced by the scheme (whether the right is actual, prospective, or contingent, and whether it is enforceable or not)."[285]

Approach to the construction of section 9

The majority held that the preferred approach to identify a scheme is to determine whether the section 9 definition is fairly satisfied.[286] The majority also considered the history of Chapter 5C but did not find this to be of assistance.[287] Justice Mason in *Australian Softwood Forests*[288] was cited in support of the proposition that the section 9 definition should not be read down by some implied limitation derived from the Chapter 5C regulatory regime.[289] Even though the explanatory memorandum, and other statements, suggest that Chapter 5C was only intended to apply to a narrow range of investment schemes there

283. *See generally*, *Brookfield Multiplex Ltd.,* 180 FCR.
284. *Brookfield Multiplex Ltd (No. 3),* FCA 450 at ¶ 10.
285. *Brookfield Multiplex Ltd.,* 180 FCR at ¶ 20.
286. *Id.* at ¶¶ 23, 33.
287. *Id.* at ¶¶ 28 - 29.
288. Australian Softwood Forests Pty Ltd v. Attorney-General (NSW)*;* Ex rel Corporate Affairs Commission (1981) 148 CLR 121 at 129 - 130.
289. *Brookfield Multiplex Ltd*, 180 FCR at ¶ 23.

was no basis from reading down the words in section 9, especially given the extensive list of express exclusions in section 9 (c) to (n) (which do not include litigation funding).[290] Accordingly, the majority began its construction by addressing the sub-paragraphs of the MIS definition "separately and in accordance with their terms."[291] Consequently, a more textual or literal approach was adopted by the majority.[292] Both Justice Finkelstein in the primary proceedings, and Justice Jacobson in dissent, were more supportive of the use of extrinsic material in their construction of section 9 and were willing to accept that the consideration of the purpose of Chapter 5C was a useful aid to construction.[293]

"A scheme that has the following features"

It was uncontroversial among both the primary and appellate judges that the litigation funding arrangement was a scheme. The majority reached this conclusion, following the relatively expansive definition stated by Justice Mason in *Australian Softwood Forests:*

> ". . . all that the word 'scheme' requires is that there should be 'some programme, or plan of action.'"[294]

The primary judge described the scheme as involving:

(a) "putting in place a group of persons willing to participate against Multiplex;

(b) ensuring that those persons would not be exposed to costs;

(c) retaining a firm of solicitors that would act on the group's behalf; and

(d) making sure that the legal fees would be paid."[295]

However, the majority preferred to characterize the scheme as having the following purpose:

- "to facilitate the realization of claims by group members against Multiplex, using legal services to be provided by MBC at the expense of the funder;
- which company also undertakes to meet any order for costs made against group members or any order for security for Multiplex's costs;
- with the intention that the Funder be reimbursed from, and derive a profit from, the proceeds of such realization; and

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290. *Id.* ¶¶ 23-35.
291. *Brookfield Multiplex Ltd,* 180 FCR at ¶ 35.
292. *Id.* at ¶¶ 35-40.
293. *Id.* at ¶¶ 212 - 213; *Brookfield Multiplex Ltd (No. 3),* 256 ALR; (2009) FCA 450 at ¶ 6.
294. Australian Softwood Forests Pty Ltd v. Attorney-General (NSW); *Ex rel Corporate Affairs Commission,* 148 CLR at 129 (quoting Clowes v. Federal Commissioner of Taxation (1954) 91 C.L.R. 209, 225).
295. *Brookfield Multiplex Ltd (No. 3),* 256 ALR at ¶ 12.

- that the group members be otherwise protected from any liability for their own costs, any order that they pay Multiplex's costs, or any order that they give security for costs in the relevant proceedings."[296]

Additionally, the majority viewed the scheme as being comprised of the following steps:

- "the Funder offering to undertake the payment of group members' costs, to meet any order for costs made against group members, and to provide security for costs if necessary;
- MBC offering to accept instructions on the basis that it will look to the Funder for its costs and outlays in accordance with the terms of the scheme;
- the group members accepting the Funder's offers and instructing MBC accordingly;
- the subsequent conduct of the matter; and
- the distribution of the resolution sums"[297] (being any money received in connection with a group members' claim such as proceeds from settlement or a favorable judgment).

"Contribute money or money's worth"

Both the primary and appellate judges (including Justice Jacobson) considered that group members contributed money or money's worth to the scheme. The appellate judges characterised the element of "money's worth" as being the promises given by the group members and those given by the Funder.[298]

"As consideration to acquire rights to benefits"

The primary judge did not accept that the contributions were made as consideration to acquire rights to a benefit.[299] That is they were not made for the purpose of the scheme. The majority did not agree and found that the contributions were made for the purpose of the scheme, because the promises given by the individual group members and the Funder respectively "were to be used collectively to provide legal services to individual groups of members, the whole group and itself," as the promises were given for the purpose of advancing both the interests of the Funder and the group.[300]

The respondents also argued that any benefits from the scheme "were not acquired in consideration of the contributions of money's worth," but rather than the benefit flowed from the contractual arrangements (and not from the scheme

296. *Brookfield Multiplex Ltd,*180 FCR at ¶ 39.
297. *Id.* at ¶ 40.
298. *Id.* at ¶ 51.
299. *Id.*
300. *Id.* at ¶ 60.

itself).[301] The majority's view was that, even if the benefits for the group members and the Funder were derived pursuant to contract, which was merely the process by which the scheme operated and had no bearing on the purpose of the contributions.[302]

"Benefits being produced by the scheme"

The majority characterised the rights derived by group members as being:

- the provision of legal services at no cost to the group members;
- absence of exposure to any adverse costs order;
- the benefit of the Funder's promises to provide security for costs; and
- the benefit of contractual rights to participate in the distribution of the Resolution Sums[303] in accordance with the terms of the scheme.

Thus, the majority held that "the Funder derived the benefit of the right to participate in the distribution of the Resolution Sums in accordance with the scheme."[304]

The majority held that section 9(i) only requires production of a "benefit," it does not require the scheme to produce "profit" or "gain."[305] Benefit is said to have a wider meaning and can include non-monetary benefits.[306] Further, the benefit does not have to be produced "once and for all at the end of the undertaking," but can be cumulative throughout the existence of the Scheme.[307]

Conversely, the primary judge found that group members did not acquire any benefits which were produced by the scheme, as: "the recovery of damages or compensation is not, by any meaning, a 'benefit' a group member has acquired. If any group member is entitled to recover damages or compensation from Multiplex it is because there is in existence a justiciable cause of action against Multiplex."[308] For the majority the benefit was not the existence of the 'cause of action' but rather the creation of a process by which money could be recovered, whether by judgment or settlement.[309] Group members were said to have received benefits including access to legal services, protection from adverse cost orders, and avoidance of a need to give security as a result of their participation in the scheme.[310]

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301. *Id.* at ¶ 70.
302. *Brookfield Multiplex Ltd,* 180 FCR at ¶ 70.
303. Resolution Sums being "any amount for which the claims are settled or for which judgment is given" in favor of the applicant or any other group member (*Brookfield Multiplex Ltd,* 180 FCR at ¶ 173).
304. *Id.* at ¶ 71.
305. *Id.* at ¶ 79.
306. *Id.*
307. *Id.* at ¶ 80.
308. *Brookfield Multiplex Ltd (No. 3),* 256 ALR at ¶ 20.
309. *Brookfield Multiplex Ltd,* 180 FCR at ¶ 76.
310. *Id.*

"Pooling" of contributions

The primary judge found that no pooling had taken place, and at best, group members had entered into a series of bilateral agreements with the funder which assigned their individual choses in action. In his view, pooling was a "physical concept" that required the interests to be held in an identifiable fund.[311]

A wider meaning of pooled was adopted by the majority. In its view, the definitive factor was the existence of a common purpose for which the "pooled" resources are to be used.[312] This purpose may be fulfilled "simply by knowing where resources are located and that they are available."[313] In this case, the pooling was effected by the group members making their individual promises available for the purpose of the scheme.[314]

Justice Jacobson (in dissent) agreed on the purposive nature of "pooling"; however, he disagreed that the group members' contributions, being their contractual authorization to receive and disburse the Resolution Sums, were pooled to produce a financial benefit.[315] He saw the purpose of the contractual undertakings as allowing for the administration and distribution of the Resolution Sums, and not the creation of any financial benefit.[316]

"Common enterprise"

The majority concluded that the scheme was also a common enterprise.[317] Unlike the primary judge, the majority's view of the scheme was that it was of a sufficiently business or commercial nature to be regarded as an "enterprise."[318] Additionally, the existence of a shared purpose, namely to prosecute the group members' claims for the benefit of group members, the funder and MBC, was sufficient to come within the definition of "common."[319]

Justice Finkelstein, in the primary proceedings, and Justice Jacobson, in dissent, both found that the litigation funding arrangements were not a common enterprise.[320] Justice Finkelstein's view was that the arrangement was not sufficiently commercial.[321] Justice Jacobson adopted the definition of "common enterprise" from *Australian Softwood Forest*, that a common enterprise must consists of two or more closely connected operations, each deriving a separate

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311. *Brookfield Multiplex Ltd (No. 3),* 256 ALR at ¶¶ 28-29.
312. *Brookfield Multiplex Ltd*, 180 FCR at ¶ 92.
313. *Id.* at ¶¶ 90 and 92.
314. *Id.* at ¶ 92.
315. *Id.* at ¶¶ 264 - 267.
316. *Id.* at ¶¶ 267-268.
317. *Brookfield Multiplex Ltd,* 180 FCR at ¶¶ 97-98.
318. *Id.* at ¶ 98.
319. *Id.* at ¶¶ 97 and 98.
320. *Brookfield Multiplex Ltd (No. 3),* 256 ALR at ¶ 31; *Brookfield Multiplex Ltd*, 180 FCR at ¶ 285.
321. *Brookfield Multiplex Ltd (No. 3),* 256 ALR at ¶ 31.

profit.[322] Consequently, Justice Jacobson found that the contributions made by the group members and the Funder were not being used in separate operations, and hence the contractual arrangements making up the litigation funding arrangement were not a common enterprise.[323] The majority's view was that the definition in *Australian Softwood* was not exhaustive, but only defined a sub-set of what might be a common enterprise.[324]

> *"to produce financial benefits, or benefits consisting of rights or interests in property, for the people (the members) who hold interests in the scheme"*

The majority held that the scheme produced the requisite financial benefit, or interest in property.[325] This followed from the arguments discussed above. In summary, the group members' promises are pooled to induce the funder to participate, which constitutes a benefit to the group members.[326] It is a financial benefit to group members as the scheme protects them from financial exposure (e.g. adverse cost orders).[327] Finally, the intention of the scheme is for the successful realization of the group members' claims, which would also confer a financial benefit for the members of the scheme.[328]

C. ASIC Relief

ASIC has granted interim class order relief to lawyers and litigation funders involved in legal proceedings structured as funded class actions until February 29, 2012.[329] This relief applies to all current and new funded class actions which would otherwise need to comply with the MIS requirements without the need for any registration or compliance with additional requirements imposed by ASIC.[330] The class order expressly includes "a scheme for participating in, conducting, and funding legal proceedings where the members of the scheme have or may have an entitlement to a remedy arising out of the same or similar circumstances" (a "Litigation Funding Scheme") within the definition of a MIS.[331] Additionally, the class order exempts a person from complying with the licensing and other provision in the Corporations Act in relation to an interest in a Litigation Funding Scheme.[332] This relief applies to conduct beginning from

322. *Brookfield Multiplex Ltd*, 180 FCR at ¶ 283.
323. *Id.* at ¶¶ 283 - 289.
324. *Id.* at ¶ 95.
325. *Id.* at ¶ 101.
326. *Id.* at ¶¶ 90-92.
327. *Id.* at ¶¶ 76-80.
328. *Id.* at ¶ 101.
329. *See* "ASIC grants interim class order relief from regulation for all funded representative actions and funded proof of debt arrangements," ASIC Media Release 10-92AD and ASIC Class Orders CO 10/333, CO 10/830, CO 11/128, CO 11/555 and CO 11/942.
330. *Id.*
331. ASIC Class Order CO 10/333.
332. *Id.*

the commencement of the class order (May 5, 2010), and does not retrospectively cover prior conduct.[333] ASIC's decision to grant class order relief came about as a result of the announcement of the government's intent to carve out litigation funding arrangements from the definition of MIS in the Corporations Act.[334] This class order relief follows transitional relief which was granted on an individual basis by ASIC and required parties to register and comply with certain requirements in order for the relief to be effective.[335]

On 27 July 2011, the Assistant Treasurer and Minister for Financial Services and Superannuation released for public consultation an exposure draft of proposed regulations to clarify that litigation funding schemes and proof of debt funding schemes are not managed investment schemes under the Corporations Act. The proposed regulations also provide exemptions from the licensing, conduct and disclosure requirements in Chapter 7 of the Corporations Act. These exemptions are conditional on appropriate arrangements being put in place to manage conflicts of interest.[336]

Effect of ASIC's arrangements on the relief flowing from Brookfield Multiplex

The relief to be granted following on from the Multiplex case was considered in *Brookfield Multiplex v. International Litigation Funding Partners Pte Ltd (No 2)* [2009] FCAFC 182 ("Brookfield Multiplex (No.2)") on December 22, 2009. This case was decided following ASIC granting the transitional relief discussed above and strongly suggested that proceedings involving litigation funding arrangements which were commenced before 4 November 2009 would not be affected by the Brookfield Multiplex case, at least until the transitional relief expired.[337]

In summary, in Brookfield Multiplex (No.2):

- The Court declared that the relevant funding arrangements constituted a managed investment scheme as defined in Chapter 5C of the Corporations Act.[338] However, it refused to declare that any particular party had contravened the Corporations Act, in part because no real attempt was made to identify which of the respondents was operating the scheme.[339]
- The Court declined to grant injunctive relief preventing the respondents from operating the scheme due to the transitional relief granted by

333. *Id.*; Bowen, *Address, supra* note 120.
334. *Id.*
335. *Id.*
336. See "ASIC grants further extension of relief – funded representative actions and funded proof of debt arrangements" ASIC Media Release 11-215AD.
337. *See supra* Part V.B.; *See* Brookfield Multiplex v. International Litigation Funding Partners Pte Ltd (No 2), (2009) FCAFC 182.
338. *Brookfield Multiplex* (No. 2), FCAFC 182 at ¶ 2.
339. *Id.* at ¶ 31.

ASIC.[340] The reasoning was that any infringing conduct was now in the past, and there was no prospect of future contravention so long as the transitional relief remains in place.[341]

- The appellants also sought orders that MBC notify group members of orders made by the Court, and of their rights under section 601MB of the Corporations Act.[342] The Court accepted the submission that there was "no reason to believe that [MBC] would do otherwise than comply with its duty to its clients."[343] The order was not made.[344]

In any event, the class order relief has clarified ASIC's and the government's current stance on the issue raised in Brookfield Multiplex (No. 2) as it expressly releases operators of litigation funding arrangements from the requirements associated with operating a MIS including holding an AFSL.[345] This class order relief is effective until February 29, 2012 and given ASIC's conduct to date it is likely to be extended until the government enacts the foreshadowed legislative reforms, or indicates a change in its position.[346]

VI. CONCLUSION - THE FUTURE OF LITIGATION FUNDING

The acceptance of litigation funding by the High Court in *Campbells Cash and Carry Pty Ltd v Fostif Pty Ltd*, its further endorsement in *Jeffrey & Katauskas Pty Ltd v SST Consulting Pty Ltd*, and the general acceptance by government that litigation funding can assist in securing access to justice, suggests that litigation funding has a bright future in Australia. However, that future is likely to include attempts at further precedent development by the funders and greater regulation by government.

A. Further Precedent Development

As demonstrated above, litigation funders have been prepared to conduct litigation so as to develop precedents that favor their business model. It is likely that this will continue in both the substantive and procedural areas of law.

In the substantive law, it is likely that litigation funders and plaintiffs' lawyers will seek to develop the securities and cartel causes of action that are pursued through class actions in the hope of making those causes of action easier to prove. For example, in the securities law area, it is likely that litigation funders will seek to have causation develop so that to prove loss caused by non-

340. *Id.* at ¶ 32. *See also id.* at ¶ 6 (stating that injunctive relief was sought by the appellants to, among other things, restrain the respondents from taking steps in furtherance of the scheme and from exercising certain rights and obligations arising out of the scheme).
341. *Id.* at ¶ 32.
342. *Id.* at ¶ 7.
343. *Brookfield Multiplex (No. 2),* FCAFC. at ¶ 28.
344. *Id.* at ¶¶ 28-32.
345. ASIC Class Order CO 10/333.
346. *Id.*; Bowen, *Address, supra* note 120.

disclosure or misleading and deceptive conduct, an entity simply needs to prove that the price paid for the security was inflated by the breach and not prove individual reliance.[347] Further, the law should be developed in the area of cartel class actions, so as to allow a plaintiff to recover from a cartel participant the full amount of any overcharge, "irrespective of the extent to which that overcharge [may have been] passed on by the plaintiff to downstream consumers."[348]

In the area of procedural law, litigation funders may wish to further secure their ability to recover a percentage of any successful class action.[349] As a result, the funders may seek to have Australian law recognize the U.S. common fund approach, whereby the entity that facilitates the creation of a fund from litigation is paid a proportion of that fund without the need for obtaining a contractual right from each group member.[350] "Further, or alternatively, they may promote the use of cy-pres damages so that the amount to be paid by an unsuccessful defendant is the loss or harm that they have caused rather than an amount that is needed to compensate the specific group members that come forward."[351] Litigation funders are also likely to push for insurers to be treated similar to litigation funders, for example, that the insurance policy a defendant may have should be disclosed the same as the litigation funding agreement that a plaintiff may have.[352]

B. Regulation

The lack of any specific regulation of litigation funding that had persisted since the Standing Committee of Attorneys-General Report in 2006 until 2010 has begun to change. Both New South Wales and Victoria have recognized the role of litigation funders in civil litigation and imposed obligations on them. Victoria and the Federal Court have mandated disclosure of funding agreements in class action proceedings and security for costs is available to assist in preventing an abuse of process. However, further regulation is needed to ensure the protection of the consumers of litigation funding. It remains to be seen whether a specific regulatory regime for litigation funders will be developed or

347. John Walker, *Litigation Funding and Challenges in Bringing a Class Action*, UNIVERSITY OF NEW SOUTH WALES - CONTINUING LEGAL EDUCATION, Sydney, Feb. 24, 2010.

348. Brooke Dellavedova and Rebecca Gilsenan, *Challenges in Cartel Class Actions,* 32UNSW L.J. FORUM 1001, 1016-1018 (2009).

349. Legg, *Reconciling Litigation Funding, supra* note 49, at 52, 56.

350. *Id.* at 52, 53.

351. Legg, *et al.*, *supra* note 60. A cy-près remedy for insertion in the New South Wales class action legislation was included in a consultation draft of the *Civil Procedure Amendment (Supreme Court Representative Proceedings) Bill* 2010 but was not enacted. *See* Clayton Utz, *Alert - NSW Rolls Back Contentious Cy-Près Rule in Class Actions Bill*, Dec. 3, 2010, *available at* http://www.claytonutz.com/publications/news/201012/03/nsw_rolls_back_contentious_cy-prs_rule_in_class_actions_bill.page.

352. Michael Lee and Dale Bampton, *Current Issues relating to Mediation in Shareholder Representative Proceedings in Australia*, 32 UNSW L.J. FORUM 988, 991-92 (2009).

whether litigation funding will become subject to more generic regulations that already exist in legislation such as the *Corporations Act* 2001 (Cth).

The extent of regulation will have an important impact on barriers to entry to the market for litigation funding. At present, new entrants need expertise in assessing and managing cases; sufficient capital to fund litigation without any return for a number of years; be able to provide security for costs; and, if unsuccessful on some cases, pay adverse costs orders. However, an entity with insufficient capital is not prohibited from being a litigation funder, and if it were to fund unsuccessful cases, the entity may need to seek the protection of the insolvency laws.

If the form of new regulation includes prudential requirements, such as having specified amounts of capital or cash at bank, then the entities that can participate in the litigation funding market will need to be more substantial. This will have the positive effect of reducing the likelihood of insolvency which could severely disrupt a particular piece of litigation. However it will also mean that the percentage that litigation funders can charge may remain above a competitive level because the users of litigation funders may have less choice. Additionally, it is possible that if litigation funding continues to result in significant returns that more entities, including those from outside of Australia, will enter the litigation funding market so as to be able to participate in those returns.

The litigation funding market looks set to continue to grow in Australia and to spread to other hospitable countries or states which will need to develop their own approach to regulation of litigation funding.

THIRD-PARTY FINANCING OF LITIGATION

*Paul H. Rubin**

ABSTRACT

The common law has long forbidden third-party investment in lawsuits based on "champerty" and related doctrines. More recently, these restrictions have been relaxed, although they may not have been entirely eliminated in the United States. While it might appear efficient to allow such investment, in fact it is not. Relaxing restrictions will have the effect of increasing litigation. One benefit of increased litigation is increased deterrence of harmful activities. However, the United States already goes much further than any other country in allowing class actions and other group-based litigation, and so these benefits are likely to be small or nonexistent. There are two external costs from increasing litigation: First, the plaintiff pays his or her own fees, but the plaintiff also imposes costs – sometimes quite significant – on defendants when a lawsuit is filed. Second, the type of lawsuit that would likely result from increased third-party investment would probably create a less efficient legal system.

I. INTRODUCTION

Financing of litigation by third parties is on the increase.[1] There is now a trade association, the American Legal Finance Association (ALFA)[2] made up of twenty-one firms, and established in 2004. In a recent New York Times article, Jonathan Glater describes firms that invest in large, often business-to-business lawsuits,[3] while the ALFA website describes investing mostly in smaller personal injury cases or similar types of cases where plaintiffs are individuals. These facts imply that such investments may take place throughout the range of legal activities. There have also been conferences recently organized on this

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1. *See* Jonathan D. Glater, *Investing in Lawsuits, for a Share of the Awards*, N.Y. TIMES, June 3, 2009, at B1.

2. AMERICAN LEGAL FINANCE ASSOCIATION, http://www.americanlegalfin.com/ (last visited Apr. 26, 2011).

3. Glater, *supra* note 1.

topic – one at Rand;[4] one at the Searle Center at Northwestern and the NKU Law Review symposium.[5]

Traditionally under the common law and most other bodies of law, such financing arrangements were illegal under the doctrines of maintenance, champerty, and barratry.[6] Maintenance is assistance in a lawsuit by someone who has no interest in the case; champerty is an agreement between a litigant and a stranger by which the stranger pursues the claim in return for a share of the proceeds; and barratry is vexatious persistence or incitement to litigation.[7] Of course, contingent fees are a form of champerty, but they are allowed in the United States.[8] However, depending on legal interpretations, one or more of these doctrines may prohibit third-party financing of lawsuits. Paul Bond indicates that champerty is currently illegal in most American jurisdictions with respect to tort claims,[9] and that champertous contracts are unenforceable under various doctrines, such as unconscionability or as being against public policy.[10] This means that someone investing in a lawsuit cannot be guaranteed that he or she can collect if the plaintiff refuses to pay. Ari Dobner suggests that parties can get around prohibitions by stating that the law of New Jersey, which allows champerty, will govern contracts for sale of lawsuits,[11] but Bond indicates that states can eliminate this possibility if they so desire.[12] More recently, ALFA has claimed that third-party financing is now legal in all states.[13] However, Sileo indicates that a recent North Carolina ruling has made such contracts illegal in that state, and they are often challenged in other states.[14] Challenges occur when borrowers (generally plaintiffs, often in tort cases) win and then refuse to repay loans. Challenges are based both on claims of champerty and on claims of

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4. UCLA SCHOOL OF LAW & RAND INSTITUTE FOR CIVIL JUSTICE, *Third Party Litigation Funding and Claim Transfer: Trends and Implications for the Civil Justice System*, http://www.law.ucla.edu/home/News/Detail.aspx?recordid=2469, (last visited Apr. 26, 2011).

5. NORTHWESTERN LAW SEARLE CENTER ON LAW, REGULATION, AND ECONOMIC GROWTH, *Public Policy Roundtable - Third Party Financing of Litigation*, http://www.law.northwestern.edu/searlecenter/conference/roundtable/Searle_Third_Party_Financing_Agenda.pdf (last visited Apr. 26, 2011).

6. Sarah Northway, *Non-Traditional Class Action Financing and Traditional Rules of Ethics: Time for a Compromise*, 14 GEO. J. LEGAL ETHICS 241, 242 (2000).

7. *Id.*

8. *Id.* at 254.

9. Paul Bond, *Making Champerty Work: An Invitation To State Action*, 150 U. PA. L. REV. 1297, 1333-41 (2002) (discussing the law in each state as of 2002).

10. *Id.* at 1307-09.

11. Ari Dobner, *Litigation for Sale*, 144 U. PA. L. REV. 1529, 1589 (1996).

12. Bond, *supra* note 9, at 1300 & n.13.

13. AMERICAN LEGAL FINANCE ASSOCIATION, http://www.americanlegalfin.com/FactsAboutALFA.asp (last visited Apr. 26, 2011) (discussing its successful efforts to overturn Ohio law).

14. Carmel Sileo, *N.C. Courts May Chill Litigation-Funding Industry, Companies Say*, TRIAL, Aug. 1, 2009, at 54-55.

usury.[15] Common law prohibitions on these practices were adopted between 1275 and 1540 in England, primarily in order to reduce the amount of litigation in society.[16]

There are, however, arguments in favor of allowing sales of tort claims, and Choharis[17] and Cooter[18] present summaries of the benefits of such a market. Basically, sale of claims would be efficiency-enhancing with respect to the parties involved in existing lawsuits, including plaintiffs, defendants, and third-party financiers. Plaintiffs would benefit because they could receive their payments sooner and with greater certainty.[19] Defendants would benefit because, in some circumstances, they could be the most efficient purchasers of tort claims, as stressed by Cooter.[20] Such sales could solve some agency problems associated with litigation between lawyers and clients,[21] and could improve the accuracy of litigation outcomes.[22] Third-party investors would of course benefit if they chose to invest. As a first approximation, allowing a market where no such investments exists will generally be efficient, unless there are externalities created by the existence of the market.

Thus, if there are arguments against allowing such sales, they must be related to externalities. I argue that there are indeed such external costs of allowing sale of legal claims. First, such a market would increase the amount and cost of litigation, and this is inefficient and inadvisable in many circumstances. Second, and more importantly, this expansion in litigation would also move the substantive law itself in certain inefficient directions.

In Section II, I discuss the nature of litigation financing, and indicate where third-party financing would be most influential. In Section III, I discuss the potential benefits of litigation. I then discuss two externalities from third party financing: increased costs of litigation in Section IV, and inefficient law in Section V.[23]

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15. BLACK'S LAW DICTIONARY 1685 (9th ed. 2009) (defining usury as "[T]he charging of an illegal rate of interest as a condition to lending money").

16. Northway, *supra* note 6, at 243.

17. Peter Charles Choharis, *A Comprehensive Market Strategy for Tort Reform*, 12 YALE J. ON REG. 435, 444-47 (Summer, 1995).

18. Robert Cooter, *Towards a Market in Unmatured Tort Claims*, 75 VA. L. REV. 383 (1989).

19. Choharis, *supra* note 17, at 480.

20. Cooter, *supra* note 18, at 411.

21. Max Schanzenbach & David Dana, How Would Third Party Financing Change the Face of American Tort Litigation? The Role of Agency Costs in the Attorney-Client Relationship (Sept. 25, 2009) (unpublished paper, Searle Center, Northwestern University Law School) (on file with author).

22. Jonathan T. Molot, A Market Approach to Litigation Accuracy (Sept. 24, 2009) (unpublished paper, Searle Center, Northwestern University Law School) (on file with author).

23. *See* Michael Abramowicz, *On the Alienability of Legal Claims*, 114 YALE L.J. 697,703-17 (2005). I ignore throughout the article the intangible costs of such a market, such as commodification and effects on corrective justice, which Abramowicz addresses in his article.

II. SOURCES OF FINANCING

There are already sources of financing for litigation, so to examine the effects of third-party finance we must first consider the existing sources.

Initially, parties can self-finance litigation. This is especially true for litigation involving businesses, either as plaintiffs or as defendants. As a plaintiff, a business will simply compare the cost of capital with the expected return from filing a lawsuit, and if the expected return is sufficient, the business will file the lawsuit. It is unlikely that the costs of a lawsuit will be sufficiently high to change the required rate of return to capital for the firm, so in the general case firms need not resort to extraordinary methods of financing. That is, the firm should be able to rely on its normal source of marginal capital to finance a lawsuit. However, if third-party financing were to become available at a lower expected cost than the internal cost of capital, additional litigation might become financially worthwhile.

As a defendant, a firm has no option but to defend itself. However, the firm can decide to settle or to litigate. Again, firms will base this decision on a comparison of the expected returns for litigating with the cost of capital. An exception will exist in the case where losing a lawsuit will lead to bankruptcy. In this case, the firm may become risk-averse and settle, even when the expected return from litigation is greater than the expected return from settling. This is apparently the pattern in many class actions, where defendant firms will litigate the class certification issue, but if the class is certified and potential damages are large enough, the firm will generally settle.[24] For matters where bankruptcy is not a threat, firms will base the decision to settle or to litigate on an analysis of returns compared with the internal cost of capital. Again, if third-party financing becomes available at a lower rate than the internal required rate of return, firms may make the decision to litigate rather than to settle.

Individuals as plaintiffs often rely on contingency fees to finance litigation. This may be so for three reasons. One reason is risk aversion: An individual may have a claim with an expected positive return (or else a contingency fee lawyer will not take the case), but the individual may not want to accept the risks associated with the lawsuit. Attorneys who take many such suits will be in a better position to spread any risks across many lawsuits. Second, individuals may also lack access to capital to finance a lawsuit. Contingent fee attorneys are implicitly loaning money to such plaintiffs for legal fees and often expenses. A third reason is simply information. Many individuals may believe that they have some injury which will lead to a legal claim. However, there is some uncertainty about the value of the claim and the probability of winning. Rational injured consumers (potential plaintiffs) will know that they do not fully understand these values and probabilities and will want honest advice as to whether the claim is

24. Northway, *supra* note 6, at 250.

worth pursuing. However, such advice is difficult to obtain due to agency problems between attorneys and clients. An hourly fee attorney, without regard to other ethics rules, will take questionable claims, perhaps with a negative expected value for the plaintiff. The best way for a potential plaintiff to be sure that the claim is worth pursuing is to hire an attorney on a contingency basis. If an attorney accepts a case on this basis, then the plaintiff knows that the claim is worthwhile. If one cannot induce an attorney to take a claim on this basis, then it is likely that the claim is not worth pursuing.

For costly cases, the contingent fee attorney is accepting some risk. For mundane cases (say, auto accidents), this risk is acceptable as the attorney can diversify over a large set of cases as long as he or she is reasonably certain about probabilities. However, for major long-term cases such as large class actions, there is much more risk and uncertainty. For victory in such cases, there is first a need to have a court certify a class. This is generally a long, expensive, and hard-fought process, and costs can run "into the millions of dollars" and cases can take "often a decade or more."[25] Law firms are now larger and better capitalized than in the past, so financing of litigation that would have been impossible for a single practitioner is now possible for many plaintiff-oriented firms.[26] Consortiums of attorneys may finance larger cases, and these large cases often lead to conflicts over roles, financing, and (in the case of settlement or victory) allocation of proceeds. It is for cases such as these that third-party financing may be most relevant. An important role for third-party financing would be to allow diversification over such large cases, each of which would otherwise impose large risks on an individual firm that accepted the case. In particular, we may think of a set of potential cases, each of which has a positive expected return but a large risk, such that losing any one case would lead to bankruptcy of the law firm. Then an individual attorney or law firm might be unwilling to accept one such case because of the risk, and unable to diversify and accept several because of time or financial limitations. Limits on economies of scale will constrain the size of plaintiff-oriented law firms, which in general seem to be smaller than defendant-oriented firms, so that litigation of many very large cases simultaneously is not feasible. It is in this situation that third-party financing would be most useful.[27] This is because such financing can separate the financial decision from the decision to litigate. Large financial investment firms could invest in several high-value, high-risk cases and have the cases litigated by separate law firms. In other words, there are greater economies of scale in finance than in litigation.

Thus, the obvious effect of increased third-party financing would be increased litigation. This is consistent with the original common law

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25. *Id.* at 247.

26. Stephen C. Yeazell, *Re-Financing Civil Litigation*, 51 DEPAUL L. REV. 183, 203-05 (2001).

27. Abramowicz, *supra* note 23, at 739.

prohibitions of such financing, which was in part aimed at reducing the amount of litigation. Indeed, Abrams and Chen find that when Australia began to allow free sale of lawsuits, it did increase the number of suits filed.[28] Moreover, the most significant change would probably be for large consumer-aggregated actions, such as product liability. In what follows, I will focus on this class of cases.

Shavell discusses the divergence between social and private incentives for litigation.[29] He indicates that there is no necessary relation between these two variables, and the private incentives may be either larger or smaller than socially-efficient incentives.[30] Some factors lead to insufficient litigation, and some to excessive litigation. The private benefit of litigation is the damages the plaintiff expects to collect, net of costs. The social benefit of litigation is the deterrence of future harmful action by parties who fear lawsuits. There is no necessary relation between these; private benefits may be larger or smaller than social benefits. I consider this difference in more detail in the next three sections.

In a discussion, Larry Ribstein asked why it is efficient to regulate the amount of litigation through controlling finance rather than directly changing the rules of litigation themselves. First, some of the rules (e.g., the "American rule" where each party pays its own legal fees) are so ingrained in the legal system that they would be difficult or impossible to change. Second, as a practical matter of political economy, it might be easier to resist a change (since some jurisdictions already limit the sale of legal claims) than to institute a new change. Once a rule exists, special interests are created that support that rule, so it is more difficult to change existing rules to allow them to continue.

III. BENEFITS FROM LITIGATION[31]

The reason Shavell identifies as to why the private benefits from a lawsuit may be smaller than the social benefits is because in some situations the loss to any individual will be too small to make a lawsuit worth filing.[32] This may occur even though filing the lawsuit would be socially optimal, because the threat of the suit will deter inefficient behavior. In this circumstance, the actual number of lawsuits filed will be less than the socially-optimal number. If one can prevent some harm with a cost of $10 per person at a cost of $5 to the potential injurer, then it should be prevented. However, no one will file a lawsuit for a potential gain of $10, so potential defendants will not take the socially-efficient level of

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28. David Abrams & Daniel L. Chen, A Market for Justice: The Effect of Litigation Funding on Legal Outcomes (2009) (unpublished manuscript).

29. STEVEN SHAVELL, FOUNDATIONS OF ECONOMIC ANALYSIS OF LAW 391 (2003).

30. *Id.*

31. By "litigation" I mean both filing of a lawsuit and the activity involved in trying or settling that lawsuit. That is, I am using the terms as a measure of legal activity.

32. SHAVELL, *supra* note 29, at 392-93.

precautions. If there are a large number of victims, then the social cost of the lack of prevention can be quite high. This type of case is of course the justification for class actions in the first place. Class actions are specifically designed to create incentives for litigation when total losses are great but no individual loss is enough to justify an individual lawsuit. Consolidations and other mass actions serve similar functions.

So, for mass action litigation financed by third parties to be socially efficient, it must be the case that the matter is expected to be risky, time-consuming, and expensive, and losses must be small for each individual but large in the aggregate. It must also be true that without such third-party financing, the case would not be brought. Of course, powerful supporters of class actions and other group-oriented litigation already exist in the United States, including non-profit legal organizations on both the left (e.g., The American Civil Liberties Union) and the right (e.g., The Institute for Justice). It is not obvious that there are gaps in litigation which could be plugged by additional class-type lawsuits financed by third parties.

The United States is already remarkably friendly towards class-type legal actions and to pro-plaintiff group actions in general. Prichard points out some of the differences between the United States and Britain.[33] First, in the United States, each party pays his or her own legal fees, but in Britain, the loser pays.[34] This means that if a British plaintiff brings an unsuccessful case, he or she is liable for the defendant's costs. Moreover, the plaintiff must personally pay these costs; the plaintiff's attorney cannot legally pay them.[35] This also means that it is much more difficult for attorneys to manipulate or change the law in their favor in Britain, and, as discussed below, such manipulation has been important in the United States.[36] Second, Britain does not allow contingent fees.[37] Although attorneys may take cases with the knowledge that they will not be paid absent victory, Britain limits the amount the attorney can recover to normal fees rather than a percentage, and this means that high-risk cases are less likely because there is little chance for a large payoff to the attorney.[38] The public finances some plaintiffs' cases, but this tends to be conservative, as well, and is mainly for relatively innocuous and sure cases on behalf of poor individuals, not for speculative high-risk cases.[39]

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33. J. Robert S. Prichard, *A Systematic Approach to Comparative Law: The Effect of Cost, Fee, and Financing Rules on the Development of Substantive Law*, 17 J. LEGAL STUD. 451 (1988).

34. *Id.* at 455.

35. *Id.* at 457.

36. *See* Paul H. Rubin & Martin J. Bailey, *The Role of Lawyers in Changing the Law*, 23 J. LEGAL STUD. 807 (1994).

37. Prichard, *supra* note 33, at 456.

38. *Id.* at 457.

39. *Id.*

Britain particularly discourages group litigation.[40] In a class action, the representative plaintiff is personally responsible for all legal fees.[41] If the case fails, this plaintiff is responsible for the losing party's legal costs as well.[42] In the United States, public interest law firms are not subject to rules of champerty, but in Britain they are. Prichard analyzed this in 1988,[43] but more recently, Mulheron has indicated that at least some of these differences have persisted.[44]

This set of rules means that precedent-seeking and group-oriented litigation is already quite advanced in the United States. Yeazell indicates that the ability of plaintiffs' law firms to finance and undertake large-scale, long-term litigation has greatly increased in the past seventy-five years.[45] While not dispositive, this evidence does create a presumption that further expansion of this sort of litigation would be unlikely to increase efficiency. Moreover, an additional effect of the difference between the British and American rules or between American practice in the past and today is that risky, relatively low-probability cases are much more likely now in the United States. Increasing the ability of third parties to invest in litigation would serve mainly to increase this tendency. Thus, we must ask if there is likely any benefit to increasing class- or group-type litigation in the United States.

The United States already spends a greater percentage of its Gross Domestic Product (GDP) on its tort system than any other country in the world,[46] and the percentage of GDP devoted to the tort system continually increases.[47] The benefits of this amount of tort and product liability litigation are not at all clear. For example, a recent paper by Polinsky and Shavell, two leading law and economics scholars, argues that the costs of the product liability system outweigh any benefits.[48] This is because the benefits are at best marginal and costs are substantial. There are several systems in place for increasing product safety, including the reputations of individual firms and direct product regulation by agencies such as the National Highway Traffic Safety Administration, the Food and Drug Administration, and the Consumer Product Safety Commission.[49] Thus, any benefits of the tort system must be an increase in safety over and above the safety that firms would provide because of reputational effects and the

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40. *Id.*
41. *Id.*
42. *Id.*
43. Prichard, *supra* note 33, at 451.
44. Rachael Mulheron, *Justice Enhanced: Framing an Opt-Out Class Action for England*, 70 MOD. L. REV. 550 (2007).
45. Yeazell, *supra* note 26.
46. TILLINGHAST-TOWERS PERRIN, U.S. TORT COSTS AND CROSS-BORDER PERSPECTIVE: 2005 UPDATE 3, 4 (2006), *available at* http://www.towersperrin.com/tp/getwebcachedoc?webc=TILL/USA/2006/200603/2005_Tort.pdf.
47. *Id.* at 6.
48. A. Mitchell Polinsky & Steven Shavell, *The Uneasy Case for Product Liability*, 123 HARV. L. REV. 1437, 1440 (2010).
49. *Id.* at 1446 & n.32.

benefits mandated by the regulatory agencies. Polinsky and Shavell make a persuasive argument that there are few, if any, such benefits.[50]

The costs of the tort system include the actual costs of litigation, as discussed above. However, there are more subtle costs, as well. In particular, the American tort system awards substantial damages for pain and suffering. However, consumers do not find this class of payments worth buying through insurance, so the effect is to increase price of products by providing insurance that consumers do not value at its cost.[51] This means that consumers in some circumstances will not be willing to purchase such goods and services which are bundled with low-value insurance. Since many of these products and services are safety-increasing (medical care, drugs), this increase in price can lead to reduced consumption, and actually lead to increased risk. Rubin and Shepherd show that state tort reform – reducing the scope of tort law – actually leads to fewer accidental deaths in the United States.[52] This indicates that tort law in this country has gone too far, and any policy that would increase the scope of this branch of law would be harmful.

IV. EXTERNAL COSTS OF LITIGATION: EXCESSIVE LAWSUITS

The cost of litigation is the amount that the parties spend on legal fees, experts, and other costs of the lawsuit, and also the costs of the court system itself. In deciding whether to file a suit, a plaintiff will consider his or her private costs (that is, his or her share of legal fees and expenses). The plaintiff will compare these costs to his or her private benefit. However, private costs are not equal to the social costs of filing the suit; there are always externalities. The major external cost of litigation is the cost to the defendant created by the decision of the plaintiff to file a lawsuit. In the United States each party pays his or her own costs, no matter what the outcome of the lawsuit is. Thus, a plaintiff in filing a lawsuit will consider his or her own costs, but will ignore any costs imposed on the defendant, and any costs of the court system itself, which are paid by taxpayers. Costs to defendants can be quite high. Indeed, for the class of cases under consideration, costs will by definition be high because these are the cases in which plaintiffs seek third-party financing, and as we have seen, those are likely to be expensive cases. Total costs of the lawsuit are generally about two-thirds of the amount at issue, and at times can become even greater than the total amount in dispute.

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50. *Id.* at 1437.

51. John E. Calfee & Paul H. Rubin, *Some Implications of Damage Payments for Nonpecuniary Losses*, 21 J. LEGAL STUD. 371, 372 (1992).

52. Paul H. Rubin & Joanna Shepherd, *Tort Reform and Accidental Deaths*, 50 J.L. & ECON. 221 (2007) (explaining that overall, from 1981-2000, state tort reform lead to approximately 24,000 fewer deaths. Noneconomic damage caps, higher evidentiary standards for punitive damages, product liability reform, and prejudgment reform reduced deaths. However, increased use of the collateral source rule increased deaths.).

Moreover, in general, total costs to business defendants will be higher than costs to consumer plaintiffs. Both parties will have costs of attorneys and experts, and these might be approximately the same.[53] However, for defendants, there will be additional opportunity costs of time and effort to executives and managers of the defendant company. These costs include time spent in searching files for documents in response to document requests, time spent in preparation for depositions and testimony, and time spent in testimony itself. Searches of e-mails and other electronic files can also be expensive and time-consuming. Additionally, of course, these costs will divert managers' attention from profit-making endeavors to the lawsuit. Defendants bear all of these costs, but generally in class actions (where the typical class member does not even know about the lawsuit), plaintiffs do not.

Thus, the first presumption is that lawsuits are socially inefficient because there is always an external cost. This presumption is, of course, rebuttable. If the social benefit of the change in behavior brought about through the threat of litigation is great enough, then this benefit will outweigh the social cost of the lawsuit. But this cost is important, and especially so in very expensive lawsuits. However, as discussed above, the additional lawsuits that would occur as a result of third-party finance are unlikely to have social benefits because of the tremendous incentive that already exists for such lawsuits in the United States.

Notice that I am ignoring the issue of damages. Damage payments are a transfer, and so have no social costs or benefits. There may be some slight increase in value in the time since plaintiffs have been harmed, and so marginal utility of money may have increased. But direct first-party insurance best captures this increase in value, and so it should not be considered a benefit of the tort system.

V. EXTERNAL COSTS OF LITIGATION: INEFFICIENT RULES

The product liability system in the United States is the result of a series of legal changes brought about through litigation. This litigation was driven by lawyers, acting largely through their trade associations, who set out to change the rules.[54] This was rent-seeking through litigation.[55] The fundamental change sought was the replacement of contracts with torts in product liability and other types of cases.[56] From the standpoint of someone who makes his living through litigation, tort law has many benefits over contract law in this context. Contract law generally restricts damages to *ex ante* agreed upon amounts, but tort law leaves them virtually open-ended. Contract law disallows consequential

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53. They will, however, be *paid* differently; plaintiffs' attorneys are paid through contingency fees, and defendants' attorneys through hourly fees. Both sets of experts are paid through hourly fees.

54. Rubin & Bailey, *supra* note 36, at 815.

55. *Id.*

56. *Id.* at 808.

damages, but they are the lifeblood of product liability litigation. Contract law also does not pay pain and suffering damages, but tort law does. Finally, modern product liability law has become based on a version of "strict liability," while contract law is more likely to be negligence-based. Strict liability will find harm and damages in more cases than will negligence. All of these factors mean that there is more litigation and larger damage payments under tort law than under contract law. Thus, it was in the interest of lawyers, the purveyors of litigation, to move from a system of contract-based product liability to a tort-based system. Furthermore, it is in their interests to continue this movement, if possible.

Moreover, lawyers were in a position to bring about this change in the United States, in part for the reasons mentioned above having to do with rules of payment and procedure. In particular, the "American rule," where each party pays its own legal fees no matter what the outcome of a lawsuit, means that there is relatively little cost for bringing highly-speculative, risky lawsuits. If the plaintiff wins, then the law is changed; if the plaintiff loses, then the lawyer is deprived of his or her time but no money. A "loser pays" rule, such as exists in most of the rest of the world, makes such suits less likely because the cost to the plaintiff if he or she loses is much greater. A rule such as that in Britain, which forbids the lawyer from paying the winning party's fees, means that there is little scope for lawyers to bring such speculative, potentially law-changing cases.

Because lawyers are involved in virtually every lawsuit and because they generally have consistent interests, litigation-seeking precedents have been a feasible method of seeking legal change. Lawyers acting through their associations have coordinated information and have been able to choose and sequence lawsuits in such a way as to create precedents favorable to the expansion of the law.

However, in this process there has obviously been some free riding. That is, some lawyers have contributed to changing the legal rules, but other lawyers have benefitted from this change without contributing. The Association of Trial Lawyers of America, under its various names (now the American Association for Justice), has attempted to coordinate this process and minimize free riding, but it has not been completely successful. Moreover, benefits have gone to plaintiffs' lawyers, but also to defendants' lawyers (who obviously cannot lobby for such change without antagonizing their clients), because they also benefit from increased litigation.[57]

One can anticipate that if third-party funding becomes feasible, some investors will find a similar process of legal expansion for rent-seeking useful, and one can also anticipate further modifications of the legal system away from efficiency and free contract and towards the interests of lawyers and those who will fund them. By definition, third-party investors will be larger than any

57. Richard A. Epstein, *The Political Economy of Product Liability Reform*, 78 AM. ECON. REV. 311, 313 (1988).).

individual law firm and involved in more cases as a method of diversification. This means that these third-party funders will be able to internalize more of the effects of legal change than individual law firms could, and so will contribute more to financing litigation leading to policy changes. These litigation funding organizations would exactly fit Galanter's model of "repeat players" who are able to change the direction of law in their favor.[58]

Large, risky, long-term cases, which may be the type of case most suitable for third-party funding, are likely to depend on changes in law. If a case turns on a factual matter, then obtaining the facts should not be so expensive and time-consuming. But if a case requires some legal change, then it may well be very risky and time-consuming. It may also be that a sequence of cases will be needed to obtain the desired result. This class of cases may be the most promising for third-party financing. Abramowicz discusses the possibility of third-party finance being used specifically for the purpose of developing precedents, although he suggests that it may not be a real issue.[59] Nonetheless, Abramowicz does have a worthwhile discussion of methods that might be used to manipulate the law. Some methods include: buying some cases with unfavorable facts to keep them from being appealed and setting a precedent; and using purchase of cases to control the order in which courts hear arguments in different cases to take advantage of the path dependence in the law.[60] He indicates that this might not be much of a problem: "Presumably, the legal system might address such interference by criminalizing such activity, holding parties who engage in such activity in contempt of court, or disallowing collusive settlements."[61] However, the tools Abramowicz describes are approximately the tools which have already been used by the trial bar to manipulate and expand tort law, and the legal system has not constrained them.[62] Indeed, it is hard to see who would have an incentive to counter such activities since *all* lawyers (both plaintiff and defendant) benefit from an expansive legal system and other parties have limited interests in any type of case. Of course there are interest groups (e.g., the American Tort Reform Association) who might have some interest, but this might be limited and it might be difficult to raise sufficient funds to do an adequate job. Those opposed to expansion of the law have diverse and fractured interests, which limits their ability to coordinate.[63]

Third-party financiers would specialize in this form of investment. This would give them incentives to grow their market, which would mean more lawsuits. This in turn would generally create an interest in inefficient law with

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58. Marc Galanter, *Why the "Haves" Come Out Ahead: Speculation on the Limits of Legal Change*, 9 LAW & SOC'Y REV. 95, 97 (1974).
59. Abramowicz, *supra* note 23, at 754-55.
60. *Id.*
61. *Id*
62. *Id.*
63. *See also* Epstein, *supra* note 57; Rubin & Bailey, *supra* note 36, at 808-13.

large damage payments, since this would increase the potential scope for investment. Modern American products liability law is already inefficient, but this inefficiency could increase and spread to more branches of the law if third-party finance becomes readily available.

VI. CONCLUSION

Third-party finance of lawsuits seems efficient because it increases the scope for free exchange. However, this appearance of efficiency is illusory, as allowing increased sale of lawsuits would create external costs in the form of incentives for inefficient lawsuits and for creation of inefficient precedents. The common law was right in forbidding champerty and its variants.

LITIGATION FINANCING IN THE U.S., THE U.K., AND AUSTRALIA: HOW THE INDUSTRY HAS EVOLVED IN THREE COUNTRIES

Nicholas Dietsch[*]

I. INTRODUCTION

More than fifteen years ago, plaintiffs in the United States began to realize that litigation financing could enable them to pursue their legal rights.[1] While litigation financing has the potential to increase access to justice for plaintiffs who otherwise could not afford to bring a suit,[2] concerns about predatory lending practices, ethical violations, and the potential illegality of these types of agreements hinder the development of litigation financing.[3] This article provides an examination of the current state of the litigation financing industries, first in the United States, second in the United Kingdom, and finally in Australia. Additionally, a comparison of the industry's evolution in each country will provide a look into the future of litigation financing.

II. LITIGATION FINANCING – HOW IT WORKS

For plaintiffs without the financial means to support themselves, their families, and a lawsuit at the same time, litigation finance companies offer one possible route to justice.[4] These companies advance money to plaintiffs and

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1. Susan Lorde Martin, *Litigation Financing: Another Subprime Industry That Has a Place in the United States Market*, 53 VILL. L. REV. 83, 83 (2008); *see also* Paul H. Rubin, Third Party Financing of Litigation, presentation at the Third Party Financing of Litigation Roundtable at Searle Center, Northwestern University Law School (Sept. 24-25, 2009), *available at* http://www.law.northwestern.edu/searlecenter/uploads/Rubin-thirdpartyfinancinglitigation.pdf (stating that in the past 75 years, plaintiff's law firms, and their ability to finance and take on large scale and long-term litigation, has substantially increased) (citing Stephen C. Yeazell, *Re-Financing Civil Litigation*, 51 DEPAUL L. REV. 183, 217 (2001)).

2. *See generally* Michael Legg & Louisa Travers, *Necessity is the Mother of Invention: The Adoption of Third Party Litigation Funding and the Closed Class in Australian Class Actions*, 38 COMMON L. WORLD REV. 245, 254 (2009) (stating that litigation finance has been promoted on the premise of extending access to justice).

3. Martin, *supra* note 1, at 86-95.

4. *See id.* at 83 (discussing the nonrecourse loans provided by litigation financing firms); *see also* Michael Herman, *Fear of Third Party Litigation Funding is Groundless*, TIMES ONLINE, Oct. 25, 2007, http://business.timesonline.co.uk/tol/business/law/article2738493.ece (stating that litigation funding allows those with money to provide the capital for court cases on behalf of those without the finances).

attorneys to cover personal and legal expenses while pursuing litigation.[5] The money advanced is not always a loan in the traditional sense,[6] and often the advances are "nonrecourse"; that is, the repayment of the advance is contingent on the plaintiff's recovery, either through a settlement or judgment.[7] Furthermore, the amount the plaintiff repays to the litigation finance company does not depend on the amount the plaintiff recovers,[8] but instead depends on the amount borrowed, the length of the litigation and a predetermined fee schedule.[9]

In spite of the sometimes exorbitant fees financing companies charge, for many plaintiffs with valid legal claims, litigation finance companies provide a financially viable option to pursue a lawsuit.[10] Therefore, for a significant portion of the population without the resources to support costly court cases, litigation financing is a solution to "a social demand crying to be met."[11]

III. ISSUES WITH LITIGATION FINANCING

A. Champerty and Maintenance

In the early 1990s, the U.S. litigation financing industry's emergence came under fire for violations of the largely archaic[12] and closely linked doctrines of

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5. Courtney R. Barksdale, *All That Glitters Isn't Gold: Analyzing the Costs and Benefits of Litigation Finance*, 26 REV. LITIG. 707, 708 (2007); *see also* U.S. CHAMBER INSTITUTE FOR LEGAL REFORM, THIRD PARTY FINANCING: ETHICAL & LEGAL RAMIFICATIONS IN COLLECTIVE ACTIONS 1 (2009), http://www.instituteforlegalreform.com/images/stories/documents/pdf/research/thirdpartyfinancingeurope.pdf [hereinafter U.S. CHAMBER INSTITUTE FOR LEGAL REFORM REPORT] (stating that funds provided by litigation finance companies are used for many different expenses including lawyer fees, court costs, expert witness fees, and plaintiff's living expenses while the litigation is pending).

6. *See* Barksdale, *supra* note 5, at 708-09 (stating that the litigation finance loans are nonrecourse if a plaintiff fails to recover a judgment they are not responsible for repayment of the loan).

7. Richard H. Braun, *Settle Now, Pay Later: A Caution About Personal Injury Loans*, OR. ST. B. BULL., May 2002, at 9; *see also* U.S. CHAMBER INSTITUTE FOR LEGAL REFORM REPORT, *supra* note 5, at 4 (stating that since the loans are nonrecourse, litigation financers are able to sidestep laws and prohibitions against excessive interest rates); Rancman v. Interim Settlement Funding Corp., 789 N.E.2d 217, 218-19 (Ohio 2003).

8. Braun, *supra* note 7, at 9. *But see* U.S. CHAMBER INSTITUTE FOR LEGAL REFORM REPORT, *supra* note 5, at 4 (stating that the litigation finance company's recovery is a pre-determined percentage of what the plaintiff eventually recovers).

9. Braun, *supra* note 7, at 9.

10. George Steven Swan, *The Economics of Usury and the Litigation Funding Industry: Rancman v. Interim Settlement Funding Corp.*, 28 OKLA . CITY U. L. REV. 753, 758 (2003); *see also* Geoffrey McGovern et al., *Third –Party Litigation Funding and Claim Transfer: Trends and Implications for the Civil Justice System,* RAND Institute for Civil Justice 19 (2009) (stating that, putting ethical issues aside, litigation finance can help level the playing filed for litigants who have "legitimate" claims but who are not financially able to litigate and have their day in court).

11. Swan, *supra* note 10, at 785.

12. Susan Lorde Martin, *Syndicated Lawsuits: Illegal Champerty or New Business Opportunity?*, 30 AM. BUS. L.J. 485 (1992) (citing Killian v. Millard, 279 Cal. Rptr. 877 (Cal. Ct. App. 1991); Intex Plastic Sales Co. v. Hall, 20 U.S.P.Q.2d (BNA) 1367 (N.D. Cal. 1991)).; *See*

maintenance and champerty.[13] Maintenance is "[i]mproper assistance in prosecuting or defending a lawsuit given to a litigant by someone who has no bona fide interest in the case."[14] Champerty, a type of maintenance, is "[a]n agreement to divide litigation proceeds between the owner of the litigated claim and a party unrelated to the lawsuit who supports or helps enforce the claim."[15]

Champerty has long been prohibited in the United States for fear that allowing the involvement of third parties in a lawsuit would promote frivolous litigation, increase damages, and hinder settlements.[16] However, many exceptions to the champerty doctrine in the U.S. exist, the most notable of which are contingency fee arrangements.[17]

All courts in the U.S. permit contingency fees to allow plaintiffs without the financial means the opportunity to sustain a lawsuit.[18] Contingency fees have been permitted on the principle that allowing a plaintiff with a meritorious claim to pursue justice is more important than preventing champerty, which court supervision can effectively eliminate.[19] Additionally, as exceptions to the champerty doctrine have developed, different states treat champertous agreements in unique ways,[20] or have eliminated champerty prohibitions altogether.[21]

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generally PERCY HENRY WINFIELD, THE HISTORY OF CONSPIRACY AND ABUSE OF LEGAL PROCEDURE 22-25 (Harold Dexter Hazeltine , Litt.D. ed., Fred B. Rothman & Co. 1982) (1921) (discussing the Statute of Conspirators in England and the prohibitions against and penalties of champerty and maintenance, as well as the penalties for engaging in such practices).

13. *See* Martin, *supra* note 12, at 485 (defining champerty and maintenance, stating that champerty is essentially a "kind of maintenance").

14. BLACK'S LAW DICTIONARY 1039 (9th ed. 2009).

15. *Id.* at 262.

16. Susan Lorde Martin, *Financing Plaintiffs' Lawsuits: An Increasingly Popular (and Legal) Business*, 33 MICH. J. L. REFORM 57, 58 (2000); *see also* Rubin, *supra* note 1, at 2 (stating that champerty was forbidden by the common law due to "correct" fears that it would result in increased litigation). *But see* Herman, *supra* note 4 (arguing that litigation finance will not lead to frivolous claims, because the financing companies operate on profit making principals and will evaluate potential claims in great detail to ensure a return on their investment).

17. Martin*, supra* note 16, at 58. *See generally* Adam Shajnfeld, *A Critical Survey of the Law, Ethics, and Economics of Attorney Contingent Fee Arrangements*, 54 N.Y.L. SCH. L. REV. 773 (2009) (discussing the historical roots, parameters, and general issues of the contingency fee agreement).

18. Susan Lorde Martin, *The Litigation Financing Industry: The Wild West of Finance Should Be Tamed, Not Outlawed*, 10 FORDHAM J. CORP. & FIN. L. 55, 57 (2004); *see also* Rubin, *supra* note 1, at 4 (stating that many plaintiffs are able to use the contingency fee agreement to pursue their claims notwithstanding their lack of personal assets).

19. Martin*, supra* note 18, at 57.

20. Lauren J. Grous, Note, *Causes of Action For Sale: The New Trend of Legal Gambling*, 61 U. Miami L. Rev. 203, 213 (2006). *See generally* Maya Steinitz, *Whose Claim is This Anyway? Third Party Litigation Funding*, 95 MINN. L. REV. (forthcoming 2011) (discussing treatment and case law showing the changing attitudes toward champerty and maintenance in U.S. states).

21. Martin, *supra* note 16, at 57; *see also* Paul Bond, Comment, *Making Champerty Work: An Invitation to State Action*, 150 U. PA. L. REV. 1297, 1333-41 (2002) (discussing significant case law in all fifty states relating to their respective treatment of champerty and maintenance).

B. Usury

Because of high fees demanded in litigation financing agreements, these agreements are frequently met with challenges under usury laws.[22] Usury is "the exacting, taking, or receiving of a greater rate of interest than is allowed by law for the use or loan of money."[23] State usury laws are similar to state champerty laws in that they both trace their roots to a long legal history and tradition.[24] The main purpose of usury laws is to protect vulnerable borrowers from predatory lending practices.[25] If a contract is found to be usurious, usury law invalidates the illegal interest term, and the lender can only recover the debt and the legal interest.[26] Although economists and commentators have argued that such laws inhibit economic growth and stifle efficiency, most states retain usury laws.[27]

The legal interest rates and elements of usury vary between states, but in most states the elements of usury include:

> [1] an agreement to lend money; [2] the borrower's absolute obligation to repay with repayment not contingent on any other event or circumstance; [3] a greater compensation for making the loan than is allowed under a usury statute or the State Constitution; [4] and an intention to take more for the loan of the money than the law allows.[28]

In the litigation financing industry, the second element is crucial because repayment of an advance is often contingent on recovery in the lawsuit.[29] However, critics of litigation financing argue that the advances are not contingent because the financing companies use information about each lawsuit to calculate the probability of recovery and advance money only when that probability is very high.[30] Critics further contend that the risk of non-repayment

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22. *See* Swan, *supra* note 10, at 764-771 (stating that usury arises when a level of interest is "unjust and unfair"). *See generally* JAMES AVERY WEBB, A TREATISE ON THE LAW OF USURY, AND, INCIDENTALLY, OF INTEREST (The F.H. Thomas Law Book Co.) (1899) (providing an in-depth discussion on the history and origin of usury, including significant case law that developed and changed usury law).

23. BLACK'S LAW DICTIONARY 2183 (9th ed. 2009).

24. Mariel Rodak, Comment, *It's About Time: A Systems Thinking Analysis of the Litigation Financing Industry and its Effect on Settlement*, 155 U. PA. L. REV. 503, 512 (2006).

25. *Id.*

26. Douglas R. Richmond, *Other People's Money: The Ethics of Litigation Funding*, 56 MERCER L. REV. 649, 665 (2005).

27. Grous, *supra* note 20, at 214.

28. Martin, *supra* note 18, at 58-59; *see also* WEBB, *supra* note 22, at 18 (stating that the first three elements must be proven by sufficiency of the evidence, while the fourth element, "intention to violate the law," may be implied if the other elements are expressed on the face of the agreement).

29. Richmond, *supra* note 26, at 665; *see also* WEBB, *supra* note 22, at 24 (stating that the obligation to pay back the loan principal is absolute).

30. Richmond, *supra* note 26, at 666; *see also* Herman, *supra* note 4 (supporting the argument that the risk is minimal because litigation finance companies operate for profit and therefore meticulously examine the claim before investing); Richard Lloyd, *Litigation and Dispute Resolution: The New, New Thing*, LEGAL WK., Sept. 30, 2010, http://www.legalweek.com/legal-

of an advance is less than the risk of non-repayment of a traditional loan.[31] They explain that although all unsecured lenders accept some risk of non-repayment of loans, traditional lenders may be less informed about their patrons than litigation finance companies.[32] While traditional lenders typically know an individual's credit history and income information, litigation finance companies make their lending decisions after learning the details of the lawsuit in question.[33]

Despite these criticisms, only a small number of state courts have directly addressed whether usury laws invalidate litigation finance agreements.[34] Because litigation finance agreements, by their terms, do not always require an absolute obligation to repay the advance,[35] U.S. courts may not have had occasion to confront this issue. Nonetheless, courts in Michigan and New York have applied a flexible definition of usury and the absolute obligation of repayment requirement to invalidate litigation finance agreements.[36]

C. Ethical Issues

Litigation finance poses a host of legal ethics issues. Arizona, Florida, New York, Ohio, South Carolina, Utah and Virginia state courts have all handed down judgments that demonstrate litigation finance's unresolved ethical questions.[37] The most glaring ethical issue is a financing agreement's potential impact on the attorney-client relationship.[38] Litigation finance agreements

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week/analysis/1736124/litigation-dispute-resolution (discussing New York based litigation finance company, Juridica Capital Management, which invests a significant amount of its capital into antitrust cases, particularly those in which liability has been admitted. Richard Fields, co-founder of Juridica, states that this investment strategy makes it "as close to a sure thing as you can get in litigation financing").

31. Julia H. McLaughlin, *Litigation Funding: Charting a Legal and Ethical Course*, 31 VT. L. REV. 615, 637-38 (2007).

32. *Id.*

33. *Id.* at 638; s*ee also* Barksdale, *supra* note 5, at 713-14 (noting that litigation finance firms request a plaintiff's medical records, accident reports and attorney-client privileged information to evaluate a claim).

34. McLaughlin, *supra* note 31, at 635.

35. *See* George Steven Swan, *Economics and the Litigation Funding Industry: How Much Justice Can You Afford?*, 35 NEW ENG. L. REV. 805, 826 (2001) (discussing Perry Walton, who runs Resolution Settlement Corporation in Las Vegas, and who arguably "discovered the litigation finance company market niche." Mr. Walton states that usury law does not apply to the litigation financing company, mainly because there is no obligation to pay back the loan if the plaintiff's suit is lost.).

36. McLaughlin, *supra* note 31, at 635.

37. Rodak, *supra* note 24, at 509.

38. *See* U.S. CHAMBER INSTITUTE FOR LEGAL REFORM REPORT, *supra* note 5, at 3 (arguing that litigation finance negatively impacts the attorney-client relationship and raises the question of the funder's position in the relationship). Funders are solely in the business to make profit; they have no obligations to "zealously" pursue their clients claim and protect confidential information. *Id. But see* Christy B. Bushnell, *Champerty is Still No Excuse in Texas: Why Texas Courts (and the Legislature) Should Uphold Litigation Funding Agreements*, 7 HOUS. BUS. & TAX L.J. 358, 385 (2007) (focusing on the benefits of litigation financing in allowing plaintiffs without adequate assets to pursue their claims, and further arguing that third party finance does not negatively impact

require that clients order their counsel to give the finance company access to their case file.[39] Such disclosure almost certainly means that attorney-client privilege is waived.[40] Consequently, a defense attorney may be able to uncover that a plaintiff has obtained an advance on a claim, identify the financing company, and obtain discovery from that company, including any documents provided by the plaintiff's lawyer.[41] Thus, opposing counsel could obtain formerly privileged information from the finance company, substantially damaging the plaintiff's claim.[42]

Another ethical concern is the litigation finance agreement's impact on the ability to terminate the attorney-client relationship.[43] Many litigation finance agreements stipulate that the entire balance of the advance and all interest accrued is immediately due if the attorney-client relationship ends.[44] Therefore, if an attorney wants to terminate the relationship with a client after the client has obtained an advance, the attorney may be unable to do so without avoiding potential ethical and malpractice claims.[45]

Further, an advance from a litigation finance company may influence a client's decision-making during a lawsuit.[46] Because fees increase as a lawsuit continues, a client's net recovery potentially diminishes the longer litigation continues.[47] This may cause a plaintiff to be more prone to accept an early settlement offer to stop the accrual of interest owed to the litigation finance company,[48] even in cases where their attorney advises that a favorable judgment resulting in a higher recovery is likely.[49] If the client follows the attorney's

the attorney-client relationship by allowing outside investors to profit from the plaintiff's claim because the financing agreements do not "deprive the original parties of their legal rights or misalign the parties").

39. Braun, *supra* note 7, at 11.

40. *Id.*

41. *Id.*

42. *Id.*

43. *Id.* at 12.

44. *Id.*

45. Braun, *supra* note 7, at 12.

46. *Id.*; *see also* U.S. CHAMBER INSTITUTE FOR LEGAL REFORM REPORT, *supra* note 5, at 13 (arguing that litigation finance companies have incentive to prolong the litigation to ensure that they obtain the value contemplated by the agreement); Steinitz, *supra* note 21, at 53-56 (discussing "[t]he fragmentation of the attorney-client-funder relationship," including issues of client control and conflicts of interest).

47. Braun, *supra* note 7, at 12; *see also* Rancman v. Interim Settlement Funding Corp., 789 N.E.2d 217, 218-19 (Ohio 2003) (setting the litigation finance company's recovery amounts dependent upon whether the case settled within twelve, eighteen, and twenty-four months).

48. Braun, *supra* note 7, at 12; *see also* U.S. CHAMBER INSTITUTE FOR LEGAL REFORM REPORT, *supra* note 5, at 13 (noting that because the litigation finance agreement usually creates a disincentive to settle below the amount contemplated by the agreement, the plaintiff may be put in a position of refusing a settlement offer that is a fair value of the claim).

49. Braun, *supra* note 7, at 12; *see also* U.S. CHAMBER INSTITUTE FOR LEGAL REFORM REPORT, *supra* note 5, at 13 (stating that third party financing agreements create the same issues contingency fees create; the plaintiff's attorney has a financial incentive to hold out for the highest settlement amount).

advice to hold out for a higher recovery, and the claim eventually fails, the client could sue the attorney for malpractice or breach of fiduciary duty.[50]

IV. LITIGATION FINANCING IN THE U.S.

Despite potential ethical hurdles, the U.S. litigation financing industry began to take root in the late 1980s and early 1990s.[51] Financing companies began accepting primarily corporate lawsuits, but have since expanded, with most of the current academic and media attention focusing on litigation financing for poor, individual plaintiff lawsuits.[52] Indeed, litigation financing companies currently work with all types of lawsuits including personal injury, patent litigation, copyright infringement, and employment discrimination.[53] The varied treatment of litigation financing in courts throughout the country demonstrates a need for a clearer, structured approach to litigation finance agreements.[54]

A. Saladini *and the "Liberal" Approach*

Some states have been extremely receptive to litigation financing.[55] For example, the Massachusetts Supreme Court has eliminated the doctrines of champerty and maintenance.[56] In *Saladini v. Righellis*, the parties had previously entered into an agreement for the plaintiff to support the defendant in a separate dispute over real estate.[57] Although the defendant settled the previous dispute, the plaintiff did not receive any funds pursuant to their agreement,[58] and when the plaintiff brought suit to enforce the agreement, the defendant moved for

50. Braun, *supra* note 7, at 12.

51. Yifat Shaltiel & John Cofresi, *Litigation Lending for Personal Needs Act: A Regulatory Framework to Legitimize Third Party Litigation Finance*, 58 CONSUMER FIN. L.Q. REP. 347, 348 (2004).

52. Martin, *supra* note 1, at 84-85. *See generally* Swan, *supra* note 35 (discussing how a great number of commentators have been proponents of litigation finance due to its result of helping the poor assert their rights in the "halls of justice").

53. Shaltiel & Cofresi, *supra* note 51, at 348; *see also* William Arthur Haynes, *Silicon Valley Companies Get Funding Source for Litigation*, SILICON VALLEY/SAN JOSE BUS. J., Jan. 18, 2010, http://www.bizjournals.com/sanjose/stories/2010/01/18/focus2.html?b=1263790800%255E2735141&page=2 (discussing litigation finance company Arca Capital Partners LLC, and their investments in Silicon Valley, particularly patent infringement cases that require an investment of $3 million to $10 million for each individual case).

54. Bond, *supra* note 21, at 1333-41. *See generally* Bushnell, *supra* note 38 (discussing litigation finance and its particularities in the state of Texas).

55. *See* Bond, *supra* note 21, at 1333-41 (discussing significant case law in all fifty states relating to their respective treatment of champerty and maintenance).

56. Saladini v. Righellis, 687 N.E.2d 1224, 1226 (Mass. 1997); *see also* Michael Abramowicz, *On the Alienability of Legal Claims,* 114 YALE L.J. 697, 700 (discussing Massachusetts's abolition of the doctrines of champerty and maintenance) (citing the court's reassurance in *Saladini* that the decision would not legalize "the syndication of lawsuits").

57. *Saladini*, 687 N.E.2d 1224, 1224.

58. *Id.* at 1225.

summary judgment on the grounds that the agreement was champertous.[59] The Superior Court judge allowed both parties to submit memoranda on the issue of whether the agreement between the parties was champertous,[60] and after a hearing, a different judge held that "the agreement was champertous and unenforceable as against public policy."[61]

On appeal, the Massachusetts Supreme Court ruled that the champerty doctrine was no longer legally effective and that modern rules were appropriate to address claims involving improper or illegal agreements.[62] The court noted that it had previously recognized a public policy against the recovery of excessive fees.[63] Further, the court held that state rules for the regulation of misconduct and frivolous lawsuits, as well as the doctrines of public policy, duress, and good faith, were more appropriate to address the validity of the modern litigation finance agreement.[64]

Other states that have invalidated champerty laws have largely followed the *Saladini's* rationale.[65] For example, in *Osprey Inc. v. Cabana Ltd. Partnership*, the Supreme Court of South Carolina abolished champerty, stating "[w]e are convinced that other well-developed principles of law can more effectively accomplish the goals of preventing speculation in groundless lawsuits and the filing of frivolous suits than dated notions of champerty."[66] Like the Massachusetts Supreme Court in *Saladini*, the *Osprey* court pointed out that state rules of professional conduct, contract law, and the doctrines of unconscionability, duress, and good faith are more appropriate ways to challenge questionable litigation finance agreements.[67]

Massachusetts, New Jersey and Arizona all take similar approaches to litigation financing by refusing to enforce the doctrine of champerty.[68] These states represent a more liberal exception to the general rule in most states that still prohibit champerty in some way.[69]

B. Rancman and the "Conservative" Approach

Some states take a more traditional approach to champerty and litigation financing.[70] A 2003 Ohio Supreme Court ruling caused a stir in the litigation

59. *Id.*
60. *Id.*
61. *Id.*
62. *Id.* at 1226.
63. *Saladini*, 687 N.E.2d 1224, 1226.
64. *Id.* (citing Berman v. Linnane, 679 N.E.2d 174, 178 (Mass. 1997); MASS. R. CIV. P. 11; MASS. GEN. LAWS ch. 237, § 6f (1986)).
65. *See* Bond, *supra* note 21, at 1333-41 (discussing significant case law in all fifty states relating to their respective treatment of champerty and maintenance).
66. Osprey, Inc. v. Cabana Ltd. P'ship, 532 S.E.2d 269, 277 (S.C. 2000).
67. *Id.*
68. Grous, *supra* note 20, at 213.
69. *Id.*; *see also* Bond, *supra* note 21, 1333-41 (discussing significant case law in all fifty states relating to their respective treatment of champerty and maintenance).
70. Martin, *supra* note 1, at 83-86 (referring to the *Rancman* case).

financing industry and among those that follow the industry.[71] In *Rancman v. Interim Settlement Funding Corporation,* the plaintiff Roberta Rancman was severely injured after a car accident and subsequently sued her insurance provider to obtain insurance benefits paid to her estranged husband.[72] Before the parties resolved the lawsuit, Rancman entered into a litigation financing agreement with Interim Settlement Funding Corporation ("Interim") and Future Settlement Funding Corporation ("FSF") for a $6,000 nonrecourse advance.[73]

The terms of Rancman's agreement stipulated that she would repay Interim $16,800 if the case was resolved within twelve months, $22,000 if the case was resolved within eighteen months, and $27,600 if the case was resolved within twenty-four months.[74] Additionally, before resolving the suit against the insurance company, Rancman obtained another advance from Interim for $1,000, for which she agreed to pay $2,800 if she received a settlement or favorable judgment.75 During the lawsuit against co-defendants Interim and FSF, Rancman testified that she understood the terms of the financing agreements.[76]

Rancman settled her lawsuit with the insurance company for $100,000 in less than twelve months, but refused to repay Interim the agreed upon amount.[77] Instead, Rancman filed a lawsuit against Interim and FSF seeking rescission of the contracts, and a declaratory judgment that the companies engaged in "unfair, deceptive, and unconscionable sales practices."[78] Eventually, the Ohio Supreme Court held in Rancman's favor, not on the grounds of unconscionability, but on the grounds of champerty and maintenance.[79]

Although the judgment relied on champerty and maintenance, the court recognized that "[i]n recent years, champerty and maintenance have lain dormant in Ohio courts."[80] Despite acknowledging that the two doctrines were largely outdated, the court found that the agreements were champertous, since Interim and FSF sought to profit from Rancman's case.[81] The Ohio Supreme Court also found that the advances constituted maintenance, because Interim and FSF each purchased a share of a lawsuit in which they did not have an independent interest, and the agreements discouraged Rancman from settling her case.[82] The court stated that the repayment terms of the contract with Interim, combined with the contingency fee Rancman owed her attorney, meant that Rancman owed so

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71. *Id.* at 88.
72. Rancman v. Interim Settlement Funding Corp., 789 N.E.2d 217, 218 (Ohio 2003).
73. *Id.*
74. *Id.* at 219.
75. *Id.*
76. Rancman v. Interim Settlement Funding Corp., No. 20523, 2001 WL 1339487, at *3 (Ohio Ct. App. Oct. 31, 2001).
77. *Rancman*, 789 N.E.2d at 219.
78. *Id.* at 219.
79. *Id.*
80. *Id.* at 220.
81. *Id.*
82. *Id.*

much that if she settled within twelve months for less than $28,000, she would receive nothing.[83] Because of the involvement of Interim and FSF in the litigation, the court reasoned that the co-defendants forced Rancman to hold out for a higher settlement than she would have without their involvement.[84] Indeed, this seems to be a valid assertion - earlier in the case Rancman rejected a settlement offer from the insurance company for $35,000.[85] Additionally, the court was averse to Interim and FSF speculating in a lawsuit for profit,[86] and expressed a strong distaste for arrangements like the one between the parties by stating "a lawsuit is not an investment vehicle."[87]

The *Rancman* holding, which affirmed Ohio's common law prohibition of champerty, has generated a significant amount of commentary.[88] The case highlights a number of obstacles that litigation finance companies struggle with in the U.S. today.[89] In addition to the traditional fears that champerty and maintenance guard against, some courts are weary of predatory lending practices in the litigation financing industry, and of investors profiting from placing bets on the outcome of litigation.[90] Despite the reasoning used by the Ohio Supreme Court to support its hard-line stance against litigation financing and champerty in *Rancman*, the effect of the judgment on future plaintiffs, as well as its potentially detrimental impact on the poor's access to litigation, should not be overlooked.[91]

C. Fausone and the Need For Regulation

The Florida case *Fausone v. U.S. Claims, Inc.* is another example of the varied approach U.S. state courts take to litigation finance agreements.[92] In 2000, Ms. Fausone commenced two lawsuits, a personal injury claim and an unrelated products liability claim.[93] In 2001, Fausone contacted U.S. Claims, Inc. ("Claims") and obtained three separate advances totaling $30,000.[94] In mid-

83. *Rancman*, 789 N.E.2d at 221.
84. *Id.*
85. *Rancman*, 2001 WL 1339487, at *3.
86. *Rancman*, 789 N.E.2d at 221.
87. *Id.*
88. Martin, *supra* note 1, at 83-86. *See generally* Jonathan D. Petrus, *Legal and Ethical Issues Regarding Third-Party Litigation Funding*, 32 LOS ANGELES LAWYER 16 (2009) (discussing how the issue of litigation finance has resulted in a "relatively small but quickly growing body of case law").
89. Martin, *supra* note 18, at 63 ("[T]he Rancman case is an excellent example of the more emotional problems faced by the litigation financing industry: courts just do not like it.").
90. *Id.* at 62-65 (discussing how investors can make large amounts of money with little risk from the legal claims of impoverished individuals, which makes litigation financing look like predatory lending).
91. Susan Lorde Martin, *Financing Litigation On-Line: Usury and Other Obstacles*, 1 DEPAUL BUS. & COM. L.J. 85, 92 (2002). *See also* Steinitz, *supra* note 20, at 9 (arguing that third party finance allows poor plaintiffs to pursue their legal rights and have their day in court).
92. Fausone v. U.S. Claims, Inc., 915 So. 2d 626, 627 (Fla. Dist. Ct. App. 2005).
93. *Id.* at 627.
94. *Id.* at 628.

2003, the case settled for over $200,000, which meant Fausone had to pay $50,937 to Claims under the financing agreement's repayment schedule.[95] Instead of honoring the agreement, she instructed her lawyer to withhold payment from Claims, who subsequently initiated arbitration proceedings.[96] In response, Fausone filed a petition for declaratory judgment, arguing that the agreement with Claims was unconscionable and violated usury law.[97] Ultimately, the District Court of Appeals of Florida found in favor of Claims, reasoning that litigation finance agreements are not treated the same as consumer loans, and finding that there are no Florida laws that regulate such agreements.[98]

The common law doctrine of champerty did not apply in *Fausone* because Florida state law requires "officious intermeddling" as an essential element of champerty.[99] In Florida, officious intermeddling is "*offering* unnecessary and unwanted advice or services; meddlesome, [especially] in a highhanded or overbearing way."[100] The court found that no officious intermeddling had occurred, because Fausone contacted Claims first, and Claims had not sought out Fausone,.[101]

The court's opinion also addressed the benefits and disadvantages of litigation finance, and highlighted the need for clear rules and regulation in the industry.[102] The court cited a Florida Bar ethics opinion, which discussed that it was ethical for Florida attorneys to provide information on litigation financing to clients, and to share information with litigation finance companies.[103] On the other hand, the ethics court discussed the potential of predatory practices by litigation finance companies, and highlighted the need for the legislature to address the matter with regulation.[104]

The *Fausone* case illustrates the unsettled approach to litigation financing in the U.S.[105] A lack of regulation regarding litigation financing means that the litigation financing industry is plagued with uncertainty.[106] Finance agreements

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95. *Id.* at 628-29.
96. *Id.* at 629.
97. *Id.*
98. *Fausone*, 915 So. 2d at 629.
99. Grous, *supra* note 20, at 214. *See generally* Bushnell, *supra* note 38, at 372 (discussing "officious intermeddling" and whether a litigation financer violates this rule by "aggressively" advertising their service and soliciting potential legal claims to invest in).
100. Grous, *supra* note 20, at 214 (emphasis added).
101. *Fausone*, 915 So. 2d at 627.
102. *Id.* at 629-30.
103. *Id.*
104. *Id.* at 630.
105. *Id.* at 627-30.
106. *See* McGovern et al., *supra* note 10, at 21 (discussing the proper role of regulation in the litigation financing industry and arguing that regulation should first focus on requiring plaintiffs to provide the litigation finance company with full disclosure of all relevant information). The article asserts that this failure of complete disclosure by the litigants has prevented third party financing companies from fully evaluating the risk of particular claims, thus stifling the litigation funding market.

create a number of conflicting issues, and without clear rules or legislation to interpret the agreements, courts throughout arrive at a wide variety of conclusions.[107] Consequently, the U.S. needs a more uniform approach to litigation financing.[108] An examination of litigation financing in the U.K. and Australia provides a better understanding of the relevant issues that accompany this uncertainty and potential ways to resolve conflicts regarding the litigation financing industry.

V. LITIGATION FINANCING IN THE U.K.

In recent years, common law countries, including the U.K., have revised champerty laws.[109] The litigation financing industry in the U.K. has experienced problems and successes similar to those experienced in the U.S.[110] Litigation financing agreements encounter problems with U.K. champerty law which, like U.S. champerty law, has a long tradition of barring such agreements.[111] However, unlike in the U.S., champerty law in the U.K. traditionally barred the contingency fee, making access to justice for the poor in the U.K. even more restrictive than in the U.S.[112] The U.K. previously barred the contingency fee for many of the same reasons litigation financing is criticized in the U.S.[113]

In an effort to expand the poor's access to justice and reduce taxpayers' expenditures on the nation's legal aid system, the U.K. relaxed its laws regarding champerty in recent decades.[114] In 1967, the U.K. decriminalized champerty and maintenance, and abolished any tort liability that may have stemmed from the two doctrines.[115] In 1990, Parliament passed the Courts and Legal Services Act, making it legal for a lawyer and client to enter into a conditional fee

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107. *See* Bond, *supra* note 21, at 1333-41 (discussing significant case law in all fifty states relating to their respective treatment of champerty and maintenance).

108. *See* Anthony J. Sebok, *The Inauthentic Claim*, 64 VAND. L. REV. 61 (2011) (contending that instead of declaring that maintenance agreements interfere with the attorney-client relationship, bar associations and other parties should institute rules providing that communication between litigants and litigation financers does not destroy the privileges inherent in the attorney-client relationship).

109. Martin, *supra* note 17, at 72-73.

110. *Id.* (stating that the U.S. and England have "relaxed" their prohibitions on champerty); *see also* U.S. CHAMBER INSTITUTE FOR LEGAL REFORM REPORT, *supra* note 5, at 7 (noting that litigation funding agreements in England and Wales are still vulnerable to arguments that they are against public policy).

111. Martin, *supra* note 17, at 73.

112. *See id.* (stating that contingency fees were banned due to the belief that they degraded the legal profession, had the potential to create unfair bargains between attorney and client, promote solicitation, and increase frivolous litigation).

113. *Id.* (citing reasons much as apprehensions regarding improper influence on the attorney-client relationship, and he encouragement of frivolous litigation).

114. *Id.*

115. Rachael Mulheron & Peter Cashman, *Third Party Funding: A Changing Landscape*, 27 CIV. JUST. Q. 312, 318 (2008).

agreement.[116] As a result of the act, the U.K. allowed the use of a "conditional fee," which is a type of contingency fee that features an agreed-upon hourly rate for legal services, and an "uplift," which represents an additional percentage of the original hourly fee if the case succeeds.[117] This uplift can be up to 100% of the original hourly fee, or up to 25% of the damages recovered.[118]

Consequently, the abolition of champerty and the introduction of the conditional fee agreement opened the door to litigation financing in the U.K.[119] One case in particular, *Arkin v. Borchard Lines, Ltd.*, has been a catalyst for expansion in the industry.[120] Yeheshkel Arkin, the owner of BCL Shipping Line Ltd. ("BCL"), sued four members of the United Information Systems Conference ("UNISCON"), a European shipping conference, accusing them of predatory pricing and other unlawful activities that resulted in BCL becoming insolvent.[121] Mr. Arkin entered into an agreement with Managers and Processors of Claims, Ltd. ("MPC"), a professional financing company, to fund a portion of the litigation expenses.[122] Under the agreement, MPC would have been paid only if Arkin's claim succeeded,[123]which it did not.[124]

The U.K. takes a "loser pays" approach to legal fees, so the losing party must pay the winner's legal costs.[125] Under this rule, Arkin should have paid the other party's legal costs.[126] However, Arkin was insolvent, so the defendants sought an order for MPC, the litigation finance company, to pay their legal fees.[127] A judge denied the order on the ground that litigation finance furthered public policy by providing access to justice.[128] Further, the judge ruled that if litigation finance agreements are not champertous, the agreements should not be discouraged by forcing the finance company to pay the adverse party's legal fees.[129]

116. Susan Dunn, *Paying For Personal Injury Claims - What Are the Options for Clients and their Representatives?*, 2009 J. PERS. INJ. L. 218, 220.
117. Martin, *supra* note 16, at 73.
118. *Id.*
119. *See id.* at 73-74 (noting that since 1998, conditional fees have been allowed in all sorts of civil cases, with the exception of family law matters).
120. Arkin v. Borchard Lines, Ltd., [2005] 1 W.L.R. 3055.
121. *Id.* at 3060.
122. *Id.* at 3061.
123. *Id.*
124. *Id.* at 3059.
125. MICHAEL NAPIER ET AL., CIVIL JUSTICE COUNCIL, THE FUTURE FUNDING OF LITIGATION - ALTERNATIVE FUNDING STRUCTURES 55-57 (2007), http://www.civiljusticecouncil.gov.uk/files/future_funding_litigation_paper_v117_final.pdf.
126. *Id.* at 56; *see also* Rubin, *supra* note 1, at 8 (explaining that in Britain, the plaintiff who brings a claim and subsequently loses must personally pay for the defendants costs). Under British law, the plaintiff's attorney is prohibited from paying the costs. Rubin, *supra* note 1, at 8.
127. *Arkin*, 1 W.L.R. at 3060.
128. *Id.* at 3062.
129. *Id.*

On appeal, the court reversed the initial judgment and ordered MPC to pay the opposing parties' costs to the extent of the funding provided.[130] The court balanced the "loser pays" rule of attorney fees with the benefits that litigation financing presents in the U.K.[131] Applying this reasoning, the court refused to force MPC to pay the opposing parties' entire costs, fearing that such a rule would serve as a disincentive for litigation finance companies to fund litigation.[132] Instead, by making the litigation finance company liable for only a portion of the opposing parties' costs, the court reasoned that the result would be to create some sort of industry regulation.[133] For instance, financiers would be inclined to cap the funds they make available to each case to limit their own liability risk, and evaluate cases with more scrutiny, funding only those with high probabilities of success.[134]

In addition, *Arkin* proved important because the court supported the important role litigation finance companies can play, and all but endorsed the litigation financing industry.[135] The decision laid down a clear-cut rule for litigation finance companies, limiting their liability in the event of a loss to the amount of money advanced, and also provided a judicial "green light" for financiers.[136]

In addition to *Arkin*, the Civil Justice Council showed support for litigation financing through its report regarding improving access to justice in the U.K.[137] First, the report noted that U.K. courts have accepted third party funding as a permissible means of financing lawsuits, and that an individual's right of access to justice should supersede the doctrines of champerty and maintenance.[138] Second, the Civil Justice Council concluded that, subject to the rules in *Arkin*, third party funding should be encouraged.[139] Finally, the Council recommended the adoption of regulation to protect consumers and the attorney-client relationship.[140]

In the 2008 case *London & Regional (St. George's Court) Ltd. v. Ministry of Defence*, the court summarized the state of litigation finance law in the U.K. The court explained that when examining a financing agreement, "the question is whether the agreement has a tendency to corrupt public justice . . . . "[141] The *L &*

130. *Id.* at 3069.
131. *Id.*
132. *Id.* at 3069-70.
133. *Arkin*, 1 W.L.R. at 3069-70.
134. *Id.* at 3069-70.
135. Dunn, *supra* note 116, at 220.
136. *Arkin*, 1 W.L.R. at 3069-70.
137. MICHAEL NAPIER ET AL., *supra* note 125, at 53.
138. *Id.* at 54.
139. *Id.* at 66.
140. *Id.*
141. London & Reg'l (St. George's Court) Ltd. v. Ministry of Def., [2008] EWHC 526 (TCC) para. 103 (citation omitted).

R court also noted that modern authorities have demonstrated a flexible approach to financing agreements and have generally enforced these agreements.[142]

However, in spite of the growth of the U.K.'s litigation financing industry, a recent study suggests the industry has not provided an adequate solution to "access to justice" problems for poor individuals.[143] Researchers from Oxford and Lincoln Universities in the U.K. issued preliminary findings showing that while current financing models have improved access to justice for small- to medium-sized companies, individual plaintiffs have not received the same benefit.[144] This paints a clear picture of the U.K.'s litigation financing industry today.[145] Instead of focusing on catering to lower-income individual plaintiffs, the industry takes a complex investment approach to financing lawsuits.[146] Hedge funds, insurers, large investment companies and private investors all finance lawsuits in the U.K.[147] In fact, most financing companies are large corporate entities with huge budgets,148 typically funding lawsuits with claims that value well over £100,000.[149] The type of corporate clients who would ordinarily enter into these agreements are usually represented by large law firms,

142. *London*, EWHC 526.

143. University of Oxford, *Third Party Litigation Funding Has Not Helped Ordinary Consumers*, http://www.ox.ac.uk/media/news_stories/2010/100602.html (last visited Feb. 20, 2011). *See generally* Nate Raymond, *More Attorneys Exploring Third-Party Litigation Funding,* N.Y. L.J., June 4, 2010*, available at* http://www.law.com/jsp/article.jsp?id=1202459195060&slreturn=1&hbxlogin=1 (stating that the "new phenomenon" is investors entering the litigation finance market and financing commercial law suits between companies).

144. University of Oxford, *supra* note 141. In addition to the study's findings on the litigation finance industry's effect on access to justice, it also revealed the participants' sentiments on regulation of the industry in the U.K. Consumer groups interviewed for the study felt that industry self-regulation was insufficient and more governmental regulation was necessary, while litigation financiers recognized the need for regulation to prevent rogue litigation finance companies from entering the industry, and that such regulation may increase the public's confidence in litigation financing.

145. *Id.*

146. Martin, *supra* note 1, at 113; *see also* Claire Ruckin & Sofia Lind, *External Funding Booms as Litigators Plot Upturn*, LEGAL WK., Mar. 20, 2008, *available at* http://www.law.com/jsp/article.jsp?id=1206009902544 (discussing the rise of litigation finance companies and outside investors entering the litigation financing business); Raymond, *supra* note 141 (stating that until recently, the U.S. litigation finance companies primarily lent small amounts of capital to claimants in personal injury cases in return for a percentage of any subsequent recovery).

147. Martin, *supra* note 1, at 113; *see also* Securities Docket, Global Securities Litigation and Enforcement Report, *Litigation Funding Starting to Pay Off*, May 5, 2009, http://www.securitiesdocket.com/2009/05/05/litigation-funding-starting-to-pay-off/ (stating that insurance companies such as Allianz (Germany) and other independent investors have begun investing in lawsuits).

148. *Id.*; *see also* Raymond, *supra* note 141 (discussing Juridica Investments Limited, which is reported to have committed $123 million to fifteen investments in twenty-two cases, and Burford Capital Ltd., which has invested $40 million in ten cases).

149. University of Oxford, *supra* note 141. *See generally* Petrus, *supra* note 88 (stating that small and middle-sized companies with limited budgets are seeking litigation financing for their commercial claims against their highly funded adversaries).

which have now begun to partner with third party litigation finance companies to offer advances to clients.[150] For example, eight of the top ten firms in the U.K. now offer, or are considering offering, external financing to clients in some cases.[151] The cooperation of large law firms and litigation finance companies in the U.K. demonstrates a "big business" approach to litigation financing, with the industry moving away from access to justice concerns and increasingly towards an investment mindset.[152]

One possible reason for the investment approach to litigation finance in the U.K. is Rule 9 of the Solicitor's Code of Conduct.[153] The U.K. originally adopted Rule 9 to maintain control over claims management companies that incorporated shares of each client's damages into their referral fee.[154] The rule deals with personal injury claims, and effectively prohibits lawyers from associating with any company that funds litigation and receives a contingency fee.[155] While Rule 9 is currently under review by the Solicitor's Rule Authority and may be changed,[156] the only way a lawyer may currently circumvent the rule is by applying for waiver and making a claim that a particular suit is of public interest and therefore deserves funding.[157] However, when no waiver is granted, Rule 9 continues to be a significant burden to poor individual plaintiffs and effectively bars the assistance of third party litigation finance.[158]

The litigation financing industry is still developing in the U.K.[159] However, in Australia, the industry has become widely accepted and arguably more successful than the U.S. and U.K. in incorporating financing agreements into the country's legal system.[160]

VI. LITIGATION FINANCING IN AUSTRALIA

Litigation financing in Australia, much like the U.K. and parts of the U.S., benefitted from the abolition of maintenance and champerty. Maintenance and

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150. Ruckin & Lind, *supra* note 144.
151. *Id.*
152. *See* Rachel M. Zahorsky, *Third-Party Litigation Funding Picks Up as U.K. Investors Eye U.S. Cases,* A.B.A. J., June 4, 2010, http://www.abajournal.com/news/article/third-party_litigation_funding_picks_up_as_uk_investors_eye_u.s._case/ (discussing two U.K. litigation finance companies, which have invested more than $160 million in at least thirty cases, including international arbitrations).
153. Dunn, *supra* note 116, at 222.
154. *Id.*
155. *Id.*
156. *Id.*
157. *Id.*
158. *Id.*
159. *See generally* Raymond, *supra* note 141 (discussing the increase in law firms and attorneys considering litigation finance, as well as the rise in U.K. investment firms branching out to advance more funds for litigation in different areas of law).
160. *See* Standing Committee of Attorneys-General, *Discussion Paper on Litigation Funding in Australia*, 4 (May 2006) [hereinafter *Discussion Paper*] (discussing the acceptance of litigation finance by Australian courts).

champerty have been abolished in the Australian Capital Territory, New South Wales, South Australia, and Victoria.[161] While early cases involving litigation finance agreements resulted in their invalidation under traditional doctrines, courts in Australia now endorse the positive role litigation finance can play in litigation.[162] The Australian litigation financing industry began around 1995 when insolvency practitioners were legally sanctioned to contract for the funding of lawsuits characterized as company property.[163] More recently, litigation finance companies have funded and managed class actions in Australia.[164]

Australian litigation finance companies typically contract with potential plaintiffs to pay the plaintiff's costs, accept the risk of paying opposing counsel's costs if the lawsuit fails, and control the lawsuit.[165] Under these contracts, litigation finance companies often receive 25% to 40% of the lawsuit's recovery, though in some cases, companies have sought up to 75% of the recovery.[166]

Australia has been more receptive to litigation financing agreements than the U.S. or the U.K.[167] In 2005, the Supreme Court of New South Wales refused to rescind a financing agreement on the grounds that the financing firm had controlled too much of the litigation.[168] The court noted that there was no public policy against such agreements,[169] and even went so far as to point out the irony of using a financing firm to finance litigation, then suing the firm based on the terms of the original agreement.[170]

The Federal Court of Australia gave its support to litigation financing in *QPSX Communications Pty. Ltd. v. Ericsson Australia Pty. Ltd.*[171] In *QPSX,* Ericsson failed to make royalty payments for its use of QPSX technology in

161. Michael Legg et al., *Litigation Funding in Australia* 3 (Univ. of N.S.W. Faculty of Law Research Series, Working Paper No. 12, 2009), *available at* http://ssrn.com/abstract=1579487.

162. Bernard Murphy & Camille Cameron, *Access to Justice and the Evolution of Class Action Litigation in Australia*, 30 MELB. U. L. REV. 399, 435 (2006). *But see* Legg & Travers*, supra* note 2, at 254 (stating that although the Australian courts no longer strike down litigation financing agreements on maintenance and champerty grounds, the abolition of the two doctrines does not prevent a court from finding the agreements invalid if they are contrary to public policy or illegal).

163. Legg et al., *supra* note 159*,* at 4.

164. *See generally* Legg & Travers, *supra* note 2 (providing a detailed explanation of class actions in Australia and how litigation finance has recently been allowed to fund such cases).

165. Renee Leon, Chief Executive, ACT Dep't of Justice & Cmty. Safety, Speech at the 2007 Conference of the Australian Insurance Law Association: Funding Litigation: A Need for Regulation? 2 (Sept. 21, 2007), *available at* http://www.aila.com.au/speakersPapers/downloads/2007_Conference/07-09-21_Renee_Leon2.doc.

166. *Id.*

167. *See generally* U.S. CHAMBER INSTITUTE FOR LEGAL REFORM REPORT, *supra* note 5, at 17-22 (discussing Australia's acceptance of litigation finance and the Fostif case, in which the Australian High Court upheld a financing agreement when the litigation finance company had "pervasive" control over the plaintiff's case).

168. Domson Pty. Ltd. v. Zhu, [2005] N.S.W.S.C. 1070, 1070.

169. *Id.* at 1071.

170. *Id.*

171. QPSX Commc'ns Pty. Ltd. v. Ericsson Austl. Pty. Ltd., [2005] 219 A.L.R. 1.

Ericsson products and failed to comply with other terms of the contract between the parties.[172] QPSX brought suit against Ericsson for breach of a licensing agreement and deceptive conduct in violation of the Australian Trade Practices Act.[173] Ericsson moved to stay the proceedings on the grounds that QPSX had entered into a litigation financing agreement with IMF Limited ("IMF"), claiming that the agreement was an abuse of process, champertous, and against public policy because IMF and QPSX were "trafficking in litigation."[174] Ericsson argued that, in sum, the agreement allowed IMF to control the course of the litigation in pursuit of its own financial gain.[175]

First, the court addressed Ericsson's champerty argument, stating that the concerns of third parties encouraging litigation were less important than the concerns of ordinary litigants gaining access to courts.[176] The court then commended the role that litigation finance companies play in planning budgets and improving the efficiency of litigation.[177] The court found the contention that IMF might seek to control or prolong the litigation to increase its fee unpersuasive, since Ericsson could not prove the manner in which IMF might have done so.[178] Ultimately, the court found that the financing agreement did not give IMF the ability to control the litigation, because there was no agreement between IMF and QPSX's counsel.[179] In dismissing the motion to stay proceedings, the court characterized the financing agreement as "an arm's length agreement conferring what the parties plainly adjudge to be economic benefits in relation to the enforcement of claimed intellectual property rights."[180]

Another watershed moment for the Australian litigation finance industry came in the 2006 case *Campbell Cash and Carry Pty. Ltd. v. Fostif Pty. Ltd.*[181] Firmstones, a litigation financier, began contacting tobacco retailers and encouraging them to sue tobacco wholesalers to recover tobacco license fees owed to the retailers.[182] Firmstones offered to act on the retailers' behalf, obtain representation, and fund the lawsuit in exchange for one-third of the recovery.[183] Fostif, one of the tobacco retailers that worked with Firmstones, subsequently sued the tobacco wholesaler Campbell's Cash and Carry to recover the back license fees.[184]

172. *Id.* at para. 2.
173. *Id.* at para. 2.
174. *Id.* at para. 11.
175. *Id.* at para. 11.
176. *Id.* at para. 53 (citing Magic Menu Sys. v. AFA Facilitators Pty. Ltd., [1997] 72 F.C.R. 261, 267).
177. *QPSX*, 219 A.L.R. at para. 56.
178. *Id.* at para. 61.
179. *Id.*
180. *Id.*
181. Legg et al., *supra* note 159, at 6-7.
182. Campbell's Cash & Carry Pty. Ltd. v. Fostif Pty. Ltd., [2006] 229 C.L.R. 386.
183. *Id.* at 390.
184. *Id.* at 390.

The High Court expressly stated that fears of adverse effects on the litigation process and predatory agreements between litigation finance companies and litigants did not warrant a broad public policy against litigation financing, nor a law that would require such agreements to meet specific standards and regulations.[185] Much like previous Australian litigation financing cases, the court seemed concerned with ensuring that the financier did not commit an abuse of the legal process,[186] holding that the degree of control the financing company had over the litigation was permissible and did not constitute officious intermeddling.[187] The result was clear - in Australia, financing companies focused on profiting from litigation can be involved in lawsuits without creating an abuse of process.[188]

Overall, Australian litigation finance companies have enjoyed freedom to operate and encountered little judicial resistance in cases where financing agreements have been challenged compared to their U.S. and U.K. counterparts.[189]

VII. COMPARING LITIGATION FINANCING IN THE U.S., U.K. AND AUSTRALIA

Though litigation financing began to develop in the U.S., the U.K. and Australia during the 1990s, there are large differences in the way that the industry operates in each respective market. From the types of clients served, to the manner in which it is viewed by courts and the legal community at large, each nation's interpretation of litigation finance is drastically different.[190] Beyond the nuances of legal history, there are a number of reasons for the varied paths that litigation finance follows in each country.

A. Litigation Finance Companies Developed To Serve Different Markets In Each Country

One of the readily observable differences between the litigation finance industries in the U.S., U.K. and Australia is the different types of clients who seek funding, the type of cases that receive funding, and the type of financier that

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185. *Id.* at 433-34.

186. Vicki Waye, *Conflicts of Interests Between Claimholders, Lawyers, and Litigation Entrepreneurs*, BOND L. REV., July 1, 2007, at 225. *See generally* Legg & Travers, *supra* note 2, at 254 (stating that the common law prohibition against third party funding of lawsuits was primarily to prevent abuses of the court process).

187. Legg et al., *supra* note 159, at 6-7.

188. Waye, *supra* note 184, at 225; *see also* Legg & Travers, *supra* note 2, at 255 (stating that the High Court in *Campbell's Cash* held that the "existing doctrines of abuse of process and the courts' ability to protect their processes" were enough to protect against a third party funder's acts that would violate principles of justice).

189. *See*, *e.g.*, *Campbell's*, 229 C.L.R. at 388-90.

190. *See generally* Steinitz, *supra* note 20 (discussing the rise of litigation financing, particularly the evolutions in Australia and U.K., and the expanse of the U.S. market).

supplies funding.[191] While litigation financing began in the three countries due to common concerns about access to justice,[192] each country's industry developed to serve different markets.[193]

The U.K. has taken a rather narrow approach to litigation finance.[194] For U.K. litigation finance companies, litigation financing is big business, with the majority of financiers retaining massive amounts of money to fund litigation involving corporate clients.[195] Further, litigation finance is largely seen as an investment, with sophisticated litigation finance companies analyzing probable outcomes of cases, investing large sums of money, and seeking even larger returns.[196] A number of successful U.K. litigation finance companies have begun to finance litigation in other countries.[197] It is for these reasons that U.K. litigation financiers largely do not address the "access to justice" issues that were the impetus of litigation finance.[198]

In contrast to litigation financing in the U.K., litigation financing in the U.S. has grown to support a wide variety of cases and clientele.[199] Though many states still prohibit or discourage financing agreements,[200] litigation finance is common for individual and corporate plaintiffs where such agreements are legally permissible.[201] In this respect, the U.S. litigation financing industry has done more to open access to courts for poor individual plaintiffs than either of its

191. *Compare* Raymond, *supra* note 141 (stating that until recently, the U.S. litigation finance companies primarily loaned small amounts of capital to claimants in personal injury cases), *and* Shaltiel & Cofresi, *supra* note 51, at 348 (stating that US litigation finance companies are engaged in an assortment of suits, and thus finance private and corporate plaintiffs), *with* Legg et al., *supra* note 159, at 4 (stating that recently, Australian litigation funding companies have financed class actions, particularly in competition securities law), Martin, *supra* note 1, at 113 (stating that the U.K. litigation financers primarily invest large amounts of capital in commercial suits), *and* University of Oxford, *supra* note 141 (stating that Britain litigation financers primarily fund corporate litigation).

192. *See generally* Steinitz, *supra* note 20 (arguing that litigation finance companies enable plaintiffs to pursue their legal rights and access justice when they advance the necessary capital required to pursue litigation).

193. *See generally supra* note 189 (comparing the markets the litigation financing industries in the U.S., U.K., and Australia serve).

194. Martin, *supra* note 1, at 113; *see also* University of Oxford, *supra* note 141 (discussing how U.K. financers have not geared their investments to poor plaintiffs, but rather to large corporations).

195. Martin, *supra* note 1, at 113; *see also* Zahorsky, *supra* note 150 (discussing U.K. investment companies that have invested millions of dollars into various legal disputes).

196. Mulheron & Cashman, *supra* note 115, at 315-316.

197. *See* Zahorsky, *supra* note 150 (discussing Juridica Investment's funding of a case being tried in New York).

198. University of Oxford, *supra* note 141.

199. Shaltiel & Cofresi, *supra* note 51, at 348 (discussing funding companies' investments in personal injury, patent and copyright infringement, and employment law cases).

200. *See generally* Bond, *supra* note 21, at 1333-41 (discussing significant case law in all fifty states relating to their respective treatment of champerty and maintenance); Martin, *supra* note 18, at 62-63.

201. Shaltiel & Cofresi, *supra* note 51, at 348; *see also* Haynes, *supra* note 53 (discussing litigation finance companies and their entrance into the Silicon Valley market).

English-speaking counterparts.[202] For example, plaintiffs in personal injury suits in the U.S. frequently enlist the assistance of litigation finance companies.[203] Perhaps one reason for this is that U.S. litigation finance companies work on a smaller scale than those in the U.K. or Australia.[204] Additionally, because of the limited number of states that have abolished champerty laws, the market in the U.S. for litigation finance companies is not as open as those in Australia or the U.K.[205]

Nonetheless, improved access to justice does not mean that litigation financing is without its opponents.[206] The division of opinion regarding litigation finance is most pronounced in the U.S.[207] Many argue that litigation finance companies are taking advantage of poor, under-educated and vulnerable plaintiffs, and that it has become a subprime industry.[208] U.S. litigation finance companies' fees typically take a higher percentage of the final recovery than in the U.K. or Australia.[209] The high fees that some litigation finance companies charge might explain why arguments based on usury law have appeared more often in cases in the U.S. than in the U.K. or Australia.[210]

In some ways, Australia's litigation finance industry is the most "accepting" of the three countries.[211] Like their counterparts in the U.K., financiers in Australia deal largely with corporate plaintiffs, [212] but have branched out into

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202. *See supra* note 189 (comparing the markets litigation financing industries in the U.S., U.K., and Australia serve).

203. Shaltiel & Cofresi, *supra* note 51, at 348.

204. *See generally* Martin, *supra* note 1, at 107-10 (discussing small U.S litigation financing companies that provide small amounts of capital to personal injury plaintiffs); Raymond *supra* note 141 (discussing how U.S. litigation funders have primarily focused on smaller cases with advances of $1,750.00 to $4,500.00).

205. Shaltiel & Cofresi, *supra* note 51, at 349.

206. Rubin, *supra* note 1 (discussing the external costs caused by litigation funding, particularly costs on defendants in the U.S. who, unlike the U.K., are forced to pay their own legal costs despite their successful defense).

207. Martin, *supra* note 1, at 84-85 (referring to commentators' disdain for the high fees litigation funders receive when a plaintiff's case is successful, and the positive aspect of litigation finance in promoting access to the courts).

208. *Id.*; *see also* Shaltiel & Cofresi, *supra* note 51, at 348 (discussing the position of investors, who are careful not to call the advances loans, and the predatory issues that arise when the agreements are carefully examined).

209. *See generally* Shaltiel & Cofresi, *supra* note 51, at 348 (comparing litigation finance rates to pay day loans, with some financers charging plaintiffs a 435% APR); U.S. CHAMBER INSTITUTE FOR LEGAL REFORM REPORT, *supra* note 5, at 5 (discussing European financiers' interest rates of 200% or more).

210. *See generally* Martin, *supra* note 91, at 89-94 (discussing the usury issues that arise in litigation finance agreements, and specifically examining the *Rancman* case).

211. *See generally* Legg & Travers, *supra* note 2; Legg et al., *supra* note 159 (looking in-depth at the litigation funding industry in Australia, particularly case law that has been instrumental in the growth of the industry).

212. *See* U.S. CHAMBER INSTITUTE FOR LEGAL REFORM REPORT, *supra* note 5, at 17 (stating that Australian litigation finance companies primarily focus on commercial litigation and group proceedings).

class action suits comprised of individuals.[213] Australian litigation finance companies have enjoyed fewer legal attacks.[214] While ethical and legal issues hinder the development of the U.S. litigation finance industry, critics in Australia have been silenced by uniform support from the courts.[215] As the *QPSX* court stated, "the development of modern funding services in commercial litigation may be seen as indicative of a need in the market place to which those developments are legitimate responses."[216] In Australia, litigation financing is regarded as a legitimate part of a lawsuit that serves a purpose.[217]

B. Varied Interpretation of Champerty Law

The manner in which courts in the U.S., U.K. and Australia interpret and apply champerty law illustrates some of the substantial differences between litigation finance among the three countries.[218] In Australia and the U.K., the laws against champerty have been abolished, and parties attempting to challenge litigation finance agreements must find other legal arguments to do so.[219] Australian courts have typically noted that challenging a financing agreement requires a party to prove an abuse of process through the financier's improper control of the lawsuit.[220] With such a high burden to meet, the likelihood of success when challenging litigation finance agreements in Australia has been very low.[221] Although several cases were stayed until the terms of the agreements could be amended, by-and-large the constraints on litigation finance companies in Australia are few.[222]

Similarly, in the U.K., a defendant's hopes of invalidating a financing agreement were dealt a severe blow in 1999 by the Access to Justice Act.[223] That year, the Act added a clause to the Courts and Legal Services Act of 1990 stating

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213. Legg et al., *supra* note 159, at 4; *see also* Murphy & Cameron, *supra* note 160, at 434-35 (discussing financing of class actions).

214. Legg et al., *supra* note 159, at 3; Campbell's Cash & Carry Pty. Ltd. v. Fostif Pty. Ltd., [2006] 229 C.L.R. 386; QPSX Commc'ns Pty. Ltd. v. Ericsson Austl. Pty. Ltd., [2005] 219 A.L.R. 1.

215. *Campbell's*, 229 C.L.R. 386; *QPSX*, 219 A.L.R. 1.

216. *QPSX*, 219 A.L.R. at para. 54.

217. *See generally* Legg et al., *supra* note 159 (discussing the Australian courts recognition of the value of litigation finance and examining cases such as *Campbell's* that have helped expand the industry in Australia).

218. *See generally* Steinitz, *supra* note 20 (discussing litigation finance in the U.S., U.K., and Australia, and the change in the laws of maintenance and champerty).

219. Mulheron & Cashman, *supra* note 115, at 318; Legg et al., *supra* note 159, at 3.

220. *QPSX*, 219 A.L.R. at para. 57.

221. *Discussion Paper*, *supra* note 158, at 4 (noting that of the twenty cases challenging litigation finance in Australia between 1998 and 2006, all upheld the validity of litigation finance agreements).

222. *Id.*

223. *See* Mulheron & Cashman, *supra* note 115, at 319 (discussing the Access to Justice Act); *see also* MICHAEL NAPIER ET AL., *supra* note 125, 53-55 (discussing the legal aid, conditional fee agreements, and litigation funding agreements provided for under the Access to Justice Act).

that no agreement that met legal contract requirements under the Act would be found unenforceable simply because it was a litigation finance agreement.[224] With this amendment, the U.K. took a clear stance that litigation finance companies offer a legitimate legal service, and any action against them would require a showing of illegality.[225] As the industry grows, courts in the U.K. have only shown a willingness to strike down financing agreements if they find potential an abuse of process, public policy violations, or illegality.[226]

In contrast to the U.K. and Australia, the U.S. generally takes a conservative approach to applying champerty law in order to determine the validity of financing agreements.[227] In the U.S., no single body of law governs litigation financing or champerty; the matter is left to the states.[228] Even so, some states like Massachusetts have opened the door to litigation finance companies by striking down champerty laws,[229] while others like Ohio have affirmed the strict application of champerty law.[230] Between those extremes, a significant number of states retain and apply champerty laws in some form,[231] though they are frequently poorly defined.[232] Courts in only a few states have directly addressed the validity of litigation finance agreements, but when such cases do arise, they are often left to turn to relics of case law in order to evaluate the legality of the agreement.[233] Even in states with clearly defined laws, the elements are not always the same.[234] This lack of legal uniformity among the states results in stunting the growth of the litigation finance industry in the U.S., and prevents companies operating in the U.S. from reaching the larger scale of those in

224. Mulheron & Cashman, *supra* note 119, at 319.

225. *Id.*

226. *See generally* MICHAEL NAPIER ET AL., *supra* note 125, at 53-59 (discussing *Arkin v. Borchard Lines, Ltd.*); U.S. CHAMBER INSTITUTE FOR LEGAL REFORM REPORT, *supra* note 5, at 7 (stating that although the U.K has abolished champerty and maintenance, they will still strike down third party funding agreements if they violate public policy or are deemed illegal).

227. *See generally* Steinitz, *supra* note 20, at 18-24 (discussing champerty and maintenance in the U.S., noting that a majority of states still maintain their prohibitions with "varying degrees of zeal").

228. Grous, *supra* note 20, at 213-214.

229. *Id.* at 214. Another example is *Kraft v. Mason*, 668 So. 2d 679 (Fla. Dist. Ct. App. 1996), in which a Florida court held that a litigation financing agreement between a sister and brother for an anti-trust action was not champertous or usurious. *But see* Steinitz, *supra* note 20, at 21 (stating that a majority of states still prohibit maintenance and champerty).

230. Rancman v. Interim Settlement Funding Corp., 789 N.E.2d 217, 221 (Ohio 2003).

231. Bond, *supra* note 21, at 1333-41 (discussing significant case law in all fifty states relating to their respective treatment of champerty and maintenance); Steinitz, *supra* note 20, at 21 (stating that a majority of states still prohibit maintenance and champerty).

232. Bond, *supra* note 21, at 1333-41; *see also* Steinitz, *supra* note 20, at 22 ("[I]t is the duty of the court to dismiss a case in which the evidence discloses that the assignment of the cause of action sued upon was tainted with champerty.") (quoting Hall v. State, 655 A.2d 827, 830 (Del. Super. Ct. 1994)).

233. *See generally* Bond, *supra* note 21 at 1333-41 (discussing significant case law in all fifty states relating to their respective treatment of champerty and maintenance).

234. *Id.* (noting that some states, like Florida and Oklahoma, require additional elements, such as "officious intermeddling").

Australia and the U.K.[235] This trend is likely to continue, since the legal risks of operating in multiple states are likely too high for many financing companies.[236]

VIII. CONCLUSION

The growth of the litigation finance industry in the U.S., the U.K., and Australia has not necessarily translated into improved access to justice for many poor, individual plaintiffs.[237] Instead, U.K. and Australian financiers deal primarily with corporate clients,[238] and U.S. financiers are only able to operate in a limited number of states where litigation financing has been received positively by courts.[239] While litigation financing, in theory, represents a lofty goal of "leveling the playing field" for poor plaintiffs,[240] that goal has yet to be fully realized.[241]

In order to give it a chance at success, Australia, the U.K. and particularly the U.S. need clear laws crafted by legislatures to govern the litigation finance industry. Currently, case law and broad common law doctrines are the basis for decisions in cases in which financing agreements are at issue.[242] Given the current operating environment, litigation finance companies will minimize risk, follow established case law, and continue funding only a select few types of clients and cases.[243] Such legislation is necessary to protect consumer-plaintiffs by limiting the amount of fees a financier may charge, as well as the amount of control they may exert over a lawsuit.[244] It would also ease industry concerns regarding vague champerty and predatory lending laws, which have led to

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235. *See generally id.* at 1333-41. *But see* Haynes, *supra* note 53 (highlighting litigation funding in Silicon Valley).

236. *See generally* Bond, *supra* note 21, at 1333-41 (discussing significant case law in all fifty states relating to their respective treatment of champerty and maintenance).

237. University of Oxford, *supra* note 141.

238. *Id.*; Martin, *supra* note 1, at 108-109.

239. *See generally* Bond, *supra* note 21, at 1333-41(listing states in which courts have upheld litigation finance agreements).

240. *See* McGovern et al., *supra* note 10, at 1 (stating that litigation financing "has the potential to equalize the bargaining power of litigants").

241. *See* University of Oxford, *supra* note 141 (discussing litigation finance in the U.K as being focused on commercial litigation); *see also* Petrus, *supra* note 88, at 17 (noting that third party finance in commercial cases helps small businesses pursue their legal claims).

242. *See* McLaughlin, *supra* note 31, at 627 (referring to personal injury cases).

243. *See generally* Shaltiel & Cofresi, *supra* note 51 (discussing the need for regulation in the litigation finance industry); Bond, *supra* note 21, at 1333-41 (highlighting the inconsistencies in the treatment of litigation finance agreements in the U.S.).

244. *See generally* Martin, *supra* note 1, at 114 (arguing that all state legislatures should abolish champerty, thus encouraging the growth of the litigation finance industry and creating more competition and lower fees for plaintiffs); Shaltiel & Cofresi, *supra* note 51, app. at (discussing the proposed "Litigation Lending for Personal Needs Act" (LLPNA) and the prohibition on interfering with the plaintiff's decisions in the litigation).

unpredictable judgments.[245] By dictating clear rules for litigation financing industries, countries can ensure better access to justice for the poor, and make strides toward equal protection under the law.

245. *See generally* Petrus, *supra* note 88, at 17 (observing that jurisdictional differences in the treatment of champerty force one to research the pertinent law before a litigation funding agreement can be executed).