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Abstract

Extract - The implication that litigation funding is a 'dirty business' that soils the courts and the legal process has been rejected by the High Court in Campbells Cash & Carry Pty Ltd v Fostif Pty Ltd,1 a decision which determined that the involvement in proceedings of a litigation financier, whose main purpose was to profit from its investment in a set of aggregated legal claims, did not of itself warrant a stay for abuse of process. In reaching its decision the High Court was focused upon the threat that litigation funding posed to the integrity of the justice system, rather than the effect of litigation funding upon the relationship between legal practitioners and their clients. The purpose of this article therefore is to consider in more detail how the tripartite relationship between legal practitioner, litigation financier and client might be managed to ensure that client interests are adequately protected in funded proceedings.

KEYWORDS: Conflicts of Interest, litigation entrepreneurs, litigation funder, claim holder

CONFLICTS OF INTERESTS BETWEEN CLAIMHOLDERS, LAWYERS AND LITIGATION ENTREPRENEURS

VICKI WAYE*

Aims and Objectives of this Article

The implication that litigation funding is a 'dirty business' that soils the courts and the legal process has been rejected by the High Court in *Campbells Cash & Carry Pty Ltd v Fostif Pty Ltd*,[1] a decision which determined that the involvement in proceedings of a litigation financier, whose main purpose was to profit from its investment in a set of aggregated legal claims, did not of itself warrant a stay for abuse of process. In reaching its decision the High Court was focused upon the threat that litigation funding posed to the integrity of the justice system, rather than the effect of litigation funding upon the relationship between legal practitioners and their clients. The purpose of this article therefore is to consider in more detail how the tripartite relationship between legal practitioner, litigation financier and client might be managed to ensure that client interests are adequately protected in funded proceedings.

The article begins with an examination of the relationship between legal practitioner and client, particularly in relation to problems associated with conflicts of interest. Various mechanisms for regulating the lawyer-client relationship are discussed, although it is noted that specific guidelines for legal practitioners vis-v-vis litigation funding have not developed. Consequently, the article finds that conflicts of interest derived from litigation funding arrangements are primarily regulated by generalised statutory duties of professional conduct, and, as between the client and legal practitioner, by fiduciary duties of loyalty and care. The article considers particular examples of conflicts that might arise between legal practitioner and client where proceedings are funded by a professional litigation funder and investigates how they might be resolved using analogies drawn from insurance case law and practice.

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Outside of the insolvency context,[2] Australian courts have not directly considered the enforceability of agreements between funders, legal practitioners and claim holders. As noted by Stone J in *Dorajay Pty Ltd v Aristocrat Leisure Ltd*,[3] there is a distinction between the effect of champerty on agreements between funders, legal practitioners and claim holders and the effect of these agreements on the processes of the court. It does not necessarily follow that because the arrangements do not facilitate abuse of process that they cannot be attacked on other public policy grounds, for example, because they undermine statutory obligations of professional conduct between legal practitioners and their clients. This article will investigate whether funding arrangements are incompatible with legal practitioners' duties towards their clients, and accordingly, whether they breach statutory and common law principles of professional conduct.

The article also considers the nature of the relationship between litigation funder and claim holder. Two particular models of relationship are outlined. Under the first model management of the proceedings is wholly delegated to the funder. Under the second model, the client maintains managerial control of the proceedings. A survey of litigation funders undertaken by the author examining their business practices is discussed to determine whether the differentiation between the two models is substantive and whether it is a matter of concern.

Potential conflicts between legal practitioners, claimholders and funders are intensified where there are multiple claim holders. The spectre of legal practitioners and funders colluding together to take advantage of hapless claimholders is less fanciful in the class action context where there are already concerns that legal practitioners fail to adequately protect and promote claim holder interests in priority to their own.[4] The article discusses these problems as well as those associated with

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2 The enforceability of a deed terminating a funding agreement made by an administrator was considered in *Domson Pty Ltd v Zhu* [2005] NSWSC 1070. The termination deed was upheld and so was the original funding agreement.

3 (2005) 147 FCR 394 at [54].

4 Coffee JC 'Understanding the Plaintiff's Attorney: the Implications of Economic Theory for Private Enforcement of Law through Class and Derivative Actions' (1986) 86 *Columbia Law Review* 669; Hensler D, Pace NM, Dombey-Moore B, Giddens B, Gross J & Moller E *Class Action Dilemmas: Pursuing Public Goals for Private Gain* [Santa Monica, CA: Rand, 2000] at pp 79 – 99; Coffee JC 'Class Action Accountability: Reconciling Exit, Voice and Loyalty in Representative Litigation (2000) 100 *Columbia Law Review* 370; Klement A 'Who Should Guard the Guardians? A New Approach to Monitoring Class Action Lawyers' (2001) 21 (1) *The Review of Litigation* 25; Legg MJ 'Judge's Role in Settlement of Representative Proceedings: Lessons From United States Class Actions' (2004) 78 *ALJ* 58 at 70; Bronsteen J 'Class Action Settlements: An Opt In Proposal' (2005) *U Ill L Rev* 903.

control of free riding upon the funder's risk and investment, with a view to the development of standard form procedures that may avoid them.

Lastly, funders' obligations toward the system of justice are discussed.

The article concludes that insofar as the relationship between legal practitioner and client is concerned, there is little to fear from litigation funding. There is little to suggest that Australian litigation funders operate otherwise than as professional service providers and lenders. While rogue operators may appear from time to time and undermine the legal practitioner-client relationship, the courts and legal disciplinary tribunals are adequately equipped to deal with them.

The relationship between legal practitioner and claim holder

In Law and Economics, agency theory is the usual starting point for trying to unravel the relationship between legal practitioners and their clients.[5] As an economic model of organisational behaviour,[6] agency theory helps to explain how and why conflicts

[5] Issacharoff S 'Legal Responses to Conflicts of Interest' in Moore DA, Cain DM, Loewenstein G & Bazerman MH (eds) *Conflicts of Interest: Challenges and Solutions in Business, Law, Medicine, and Public Policy* [Cambridge: Cambridge Uni Press, 2005] at p189; Dal Pont G *Lawyers' Professional Responsibility in Australia and New Zealand* 2nd ed [2001] at p49; Cohen GC 'When Law and Economics Met Professional Responsibility' (1998) 67 *Fordham Law Review* 273; Ribstein LE 'Ethical Rules, Agency Costs, and Law Firm Structure' (1998) 84 *Virginia Law Review* 1707; Langevoort D & Rasmussen RK 'Skewing the Results: The Role of Lawyers in Transmitting Legal Rules' (1997) 5 *Cal Interdisc L J* 375; Macey JR & Miller GP 'An Economic Analysis of Conflict of Interest Regulation' (1997) 82 *Iowa L Rev* 965; Gilson RJ & Mnookin RH 'Disputing Through Agents: Cooperation and Conflict in Litigation' (1994) 94 *Columbia L Rev* 509; Epstein RA 'The Legal Regulation of Lawyers' Conflicts of Interest' (1992) 60 *Fordham L Rev* 579; Coffee JC n4; Miller GP 'Some Agency Problems in Settlement' (1987) 16 *J Legal Stud* 189, 203; Fridman GHL 'Lawyers as Agents' (1987) 36 *U New Brunswick L J* 9.

[6] Ross SA 'The Economic Theory of Agency: The Principal's Problem' (1973) *Am Econ Rev* 134; Jensen MC & Meckling WH 'Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure' (1976) 3 *J Financ Econ* 305; Shavell S 'Risk Sharing and Incentives in the Principal and Agent Relationship' (1979) 10 *Bell J Econ* 55; Harris M & Raviv A 'Optimal Incentive Contracts, Asset Ownership, and Job Design' (1991) *J L Econ & Org* 24; Fama EF 'Agency Problems and the Theory of the Firm' (1980) 88 *Journal of Political Economy* 288; Grossman SJ & Hart OD 'An Analysis of the Principal-Agent Problem' (1983) 51 *Econometrica* 7; Pratt JW & Zeckhauser RJH (eds) *Principals and Agents: The Structure of Business* [Boston: Harvard Business School Press, 1985]; Stiglitz J 'Principal and Agent' in Eatwell J, Milgate M and Newman P (eds) *The new Palgrave: A dictionary of economics* [London: The Macmillan Press Limited, 1987]; Dees GJ 'Principals, Agents, and Ethics' in Bowie NE & Freeman RE (eds) *Ethics and Agency Theory: An Introduction* [New York & Oxford: Oxford Uni Press, 1992]; Petersen T 'The Economics of Organization: The Principal-Agent Relationship' (1993) 36 *Acta Sociologica* 277.

of interest can arise between clients as principals and legal practitioners appointed to advise and act on their behalf as agents. Agency theory postulates that when a principal appoints an agent certain problems arise that incur 'agency costs'. These problems include:

- Adverse selection. Agents like lawyers differ in their levels of ability, diligence and honesty. However, market signals to assist agent selection are muted by restrictions on advertising for legal services.[7] Consequently, clients, especially non-repeat players, are generally unable to differentiate between good and bad lawyers. Nor are potential clients easily able to compare prices for legal services. Although some law firms offer a fixed or flat fee for simple transactions, most Australian law firms charge at an hourly rate.[8] Disciplinary rules require firms to provide clients with estimates of the overall cost of conducting a matter, but it is difficult to shop around between law firms and compare estimates that provide little information about the relative values of the services to be provided.[9]
- Information asymmetry. Typically agents know more about the appointed task than their principals. Thus lawyers know more about the nature of the legal work that they have been retained to perform than their clients, in the same way that doctors know more about medical practice than do their patients. As a result of uncertainty surrounding many legal disputes, the goals articulated in retainers for legal service do not guarantee any particular outcome. Retainers are typically couched in terms of services to be performed. However, many clients of legal practitioners do not know what relevant performance standards might apply to those legal services and are not in a position to judge whether performance standards are being met.[10]
- Divergent Goals. Under agency theory, it is assumed that the agent's preferences regarding performance of the service do not match the principal's preferences.[11]

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7 Ross Y *Ethics in Law: Lawyers' Responsibility and Accountability in Australia* 3rd ed [Australia: Butterworths, 2001] at 3.27 – 3.28.

8 The Hon Bob Debus 'Directions in Legal Fees and Costs' (2004) 10 *UNSW Law Journal Forum* 2, 2.

9 Ibid, at p3; Brabazon M 'Costs Disclosure: New Regime more Extensive and Onerous than its Predecessor' (2005) 43 *Law Society Journal* 58.

10 Moorhead R, Sherr A & Paterson A 'What Clients Know: Client Perspectives and Legal Competence' (2003) 10 *International Journal of the Legal Profession* 5 finding that clients generally rate legal professionals highly on the basis of indiscriminate service criteria such as timeliness of service delivery and demonstrated respect even where the legal advice provided was incorrect or inadequate. The study found only a weak link between client satisfaction and actual quality of service.

11 Shapiro S 'Agency Theory' (2005) *Annu Rev Sociol* 263, 264.

> This derives from the fact that the agent does not fully capture the benefits of his or her labour when performing the service on the principal's behalf.[12] Thus, in the lawyer-client relationship it is assumed that the rational self-interested client's preference will be to maximize claim value whereas the rational self-interested lawyer's interest will be to maximize fees and to minimize effort. Clearly these preferences are incompatible to the extent that excessive legal fees or lack of diligence and competence in the performance of the legal service reduce claim value.

Agency costs comprise the costs of trying to, or failing to resolve the problems outlined above. These costs include the cost of drafting contractual terms designed to better align the interests of the agent and the principal, for example, drafting executive compensation packages tied to corporate performance;[13] monitoring costs, such as imposition of key performance indicators and regular reporting on the progress of implementation;[14] or the loss of wealth that occurs to the principal if contractual requirements or monitoring fail to prevent defalcation.

As with any model dependent upon assumptions concerning human motivation and behaviour, the agency theory has shortcomings. First, it relies upon assumptions of rational self-interest and takes no account of social preferences and the role of professionalism and ethics.[15] In reality, clients are often motivated by values other than claim maximization.[16] Similarly, lawyers are affected by personal satisfaction and the benefit to their reputation gained when they perform legal services to a high standard. The assumption that lawyers would, if they could, charge excessive legal fees and minimize effort is an overdrawn stereotype, although most legal scholars would concede that absent some form of monitoring and sanction of legal practitioners, instances of self-dealing and shirking will occur.[17] Further, by concentrating on heinous breaches of client trust, the model sublimates more esoteric

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12 Macey JR & Miller GP n1024 at p969.

13 Chaudhri V 'Executive Compensation: Understanding the Issues' (2003) 36 (3) *The Australian Economic Review* 300.

14 Wholey JS 'Performance Based Management' (1997) 26 (3) *Public Manager* 36.

15 In this respect, Kiser 'Comparing Varieties of Agency Theory in Economics, Political Science and Sociology: An Illustration form State Policy Implementation' (1999) 17 *Sociological Theory* 146, 150 characterises agency theory in economics as 'parsimonious' and 'narrow in empirical scope'.

16 A study undertaken by Korobkin R & Guthrie C 'Psychology, Economics and Settlement: A New Look at the Role of the Lawyer' (1997) 76 *Tex L Rev* 77 found that lawyers were more likely to evaluate settlement and litigation options according to expected financial return. Clients were more likely to take account of non-financial values. See further Redmount RS 'Psychological Discontinuities in the Litigation Process' (1959) *Duke Law Journal* 571.

17 Macey JR & Miller GP n6 at pp968 – 969.

and generalized goal divergence. The model does not, for example, consider the impact of adversarial lawyering upon client welfare,[18] nor does it capture the impact of cultural insensitivity or other forms of systemic bias within the legal profession that might deleteriously affect client interests.[19] Human motivation is far more complex and multi layered than envisaged by agency theory.

Second, agency theory tends to view any problems arising in the relationship between principal and agent through the lens of a principal seeking to protect itself from an agent's opportunism. It fails to take account of the potential for the principal to take advantage of information asymmetries operating in its favour and does not articulate any obligations that the principal might owe to the agent. For example, it does not acknowledge the client's moral obligation to provide full and frank instructions to the lawyer or to provide access to information and evidence. Nor does the model consider the effect of client pressure upon lawyers to undertake something illegal or unethical, such as issuing proceedings for the purpose of placing a defendant under illegitimate commercial pressure.[20] Agency theory also downplays the clients' role in the production of legal services.[21] In fact, legal services comprise a complex mix of client instructions, co-operation from employees and associates of the client, the marshalling of documents and other evidence held by the client, expertise from third parties, legal drafting, advice and representation. By contrast, the principal-agent model is a one-way street, with the agent performing a particular task at the principal's behest with otherwise little input from the principal.[22]

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18 Cohen JR 'The Culture of Legal Denial' (2005) 84 *Neb L Rev* 247; Menkel-Meadow C 'The Lawyer as Problem Solver and Third-Party Neutral: Creativity and Non-Partisanship in Lawyering' (1999) 72 *Temple L Rev* 785, 790 posing the question of whether adversarial tactics benefit clients' long term interests; Menkel-Meadow C 'The Trouble with the Adversary System in a Postmodern, Multicultural World' (1996) 38 *William & Mary Law Rev* 5 arguing that adversarialism limits remedial options.

19 Jacobs M 'People from the Footnotes: The Missing Element in Client-Centred Counselling' (1997) 27 *Golden Gate U L Rev* 345; Menkel-Meadow C 'Excluded Voices: New Voices in the Legal Profession Making New Voices in the Law' (1987) 42 *U Miami L Rev* 29 - outlining the legal profession's exclusion of feminist views.

20 Lamb D 'Ethical Dilemmas: What Australian Lawyers Say About Them' in Parker S & Sampford C *Legal Ethics and Legal Practice: Contemporary Issues* [Oxford: Clarendon Press, 1995] at pp225 – 229 – explaining that resisting pressure from clients to act unethically was one of the primary ethical dilemmas Australian lawyers faced. Also problematic were situations where the lawyer suspected that the client was not being candid, and had to determine whether their client's conduct or instructions should be investigated.

21 Robertson M 'Principal, Producer and Consumer: the Client's role in the Co-Production of Lawyers' Services' (2002) 56 *Newcastle Law Review* 35.

22 Luban D *Lawyers and Justice* [Princeton: Princeton Uni Press, 1988] at p326.

Third, the principal-agent model is a narrow two-dimensional model. Although it can accommodate multiple agents and multi-tasking, it does not easily accommodate multiple principals. For example, it provides little illumination for lawyers regarding the balance of their obligations to a range of clients (some with conflicting interests), to the courts, to the justice system as a whole or to another actor in the lawyer-client relationship such as a litigation funder or insurer. In all common law jurisdictions, legal practitioners are said to owe allegiance to the rule of law and are regarded as normatively more than their clients' agents.[23]

Finally, the principal-agent model in Law and Economics theory is intended primarily to assist the principal design contractual terms, monitoring systems, incentives and sanctions to align its interests with that of the agent and to thereby reduce 'agency cost'. In the earlier economic literature, for example, agency theory was put forward as an explanation for why particular forms of governance were adopted by business organizations.[24] More recently, the concern of Law and Economics literature has shifted in focus to the design of compensation packages that better align the interests of corporations and their chief executives,[25] and the design of systems and regulations to ensure auditor independence.[26] The literature assumes that principals are 'in the driver's seat,'[27] fully competent and empowered to draft contractual terms that incorporate their preferences and implement the incentives required to ensure that agents perform their task well. Consequently, the theory may be of limited utility to agents if they are effectively incapacitated or disempowered from engaging in rational bargaining.

Some clients, like insurers or the government, are powerful repeat players in the legal services market.[28] They are generally well informed about the nature of legal services required to perform a task and the relevant professional standards applicable.

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23 Felstiner WF 'Synthesising Socio-Legal Research: Lawyer-Client Relations as an Example' (2001) 8 (3) *International Journal of the Legal Profession* 191, 192.

24 Jensen MC & Meckling WH n6; Fama EF & Jensen MC 'Separation of Ownership and Control' (1983) 26 *Journal of Law and Economics* 301.

25 Eg Garen JE 'Executive Compensation and Principal-Agent Theory' (1994) 102 *Journal of Political Economy* 1175; Chaudhri n13; Bebchuk L & Fried JM 'Executive Compensation as an Agency Problem' (2003) 17 *Journal of Economic Perspectives* 71.

26 Eg Adams MB 'Agency Theory and the Internal Audit' (1994) 9 *Managerial Auditing Journal* 8; Vinten G 'The Corporate Governance Lessons of Enron' (2002) 4 (2) *Corporate Governance* 4; Baker CR & Owsen DM 'Increasing the Role of Auditing in Corporate Governance' (2002) 13 *Critical Perspectives on Accounting* 783;

27 Shapiro n11 at p267.

28 Galanter M 'Why the "Haves" Come Out Ahead: Speculations on the Limits of Legal Change' (1974) 9 *Law & Soc Rev* 95 – arguing that repeat players are more likely to succeed in the legal system.

Insurers and the government are also well placed to bargain for terms (such as budget capping) that favour and protect their interests. On the other hand, many individual 'one-off' clients are unable to effectively address agency cost. Individual non-repeat clients are disadvantaged by acute information asymmetry. They are unlikely to be able to discriminate between various legal strategies open to pursue a claim, to understand the requisite amount of time required to carry out particular strategies, and, as outlined earlier, cannot tell whether the strategies have been performed well. Consequently, they are not in a position to effectively monitor their lawyers. Where the client is a member of a large class action effective monitoring is even less likely.[29] Further, as a result of champerty and maintenance, individual clients cannot easily incorporate contractual terms that do not rely upon effective monitoring to better align their interests with that of their lawyers. Contingency fees remain unlawful in Australia and England. As a result, the state must step in and provide incentives and deterrents in the form of regulation.

Regulation of the legal profession in Australia comprises a mix of common law, statute, administrative oversight and self-generated ethical rules. However, the article will not examine all of these in detail. Briefly, they include:

- Barriers to entry and licensing. Legal practitioners who satisfy strict admission criteria enjoy a statutory monopoly over the provision of legal services. Admission criteria include legal educational qualifications, good character qualifications, and satisfaction of practical experience requirements.[30]
- Compulsory Insurance. All practicing legal practitioners must contribute to a fidelity fund to remain qualified for legal practice.[31]
- Imposition of Fiduciary Duty. Legal practitioners are fiduciaries in the discharge of their duties to their clients.[32] Consequently, except as provided by the terms of their retainer, legal practitioners are not permitted to benefit themselves as a result of their relationship with their client and must not permit conflicts of interest, including perceived conflicts of interest, to continue once they arise

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29 Macey JR & Miller GP n5 at p971.

30 Ross Y n7 at Ch 6.

31 S19 *Legal Practitioners Act 1981* (SA); s51 *Legal Profession Act 1993* (Tas); s3.5.2 *Legal Profession Act 2004* (Vic); s156 *Legal Profession Act 2004* (Qld); s90B *Legal Practitioners Act* (NT); s430 *Legal Profession Act 2004* (NSW); s78 *Legal Practitioners Act 1970* (ACT); s60 *Legal Practice Act 2003* (WA).

32 *Nocton v Lord Ashburton* [1914] AC 932; *Boardman v Phipps* [1967] 2 AC 46; *Stewart v Layton (t/as BM Salmon Layton & Co)* (1992) 111 ALR 687; *Carindale Country Club Estate Pty Ltd v Astill* (1993) 42 FCR 307.

without the client's fully informed consent.[33] The courts apply legal practitioners' fiduciary duties strictly. As a result, a breach of fiduciary duty will occur even where the legal practitioner acted in good faith or where the client benefited from the breach.[34]

- Statutory Duties to Clients. Commonwealth and State-Attorneys-General have devised a model code for implementation in each State governing, among other matters, uniform rules regarding trust accounts and fidelity funds; uniform definitions of misconduct; standardized requirements for disclosing information about legal costs; and recognition of foreign practice qualifications. In 2004, the model code was enacted in New South Wales, Queensland and Victoria as the *Legal Profession Act*. Other Australian jurisdictions are expected to follow but in the meantime also impose diverse statutory duties prohibiting professional misconduct.[35]

- Professional Codes of Conduct. The Law Council of Australia has promulgated Model Rules of Professional Conduct,[36] which have been adopted[37] or which are similar to many of the rules operating in each Australian State and Territory. These professionally generated ethical rules impose standards for relations with clients; advocacy and litigation; relations with legal practitioners; and relations with third parties. The model *Legal Profession Act* makes Professional Codes of Conduct binding upon all Australian legal practitioners.[38]

- Supervision by Professional Bodies, Tribunals and the Courts. Australian jurisdictions adopt a three-tier system of supervision and redress concerning complaints against legal practitioners. In jurisdictions, which apply the model *Legal Profession Act*, a legal services commissioner deals with low-level complaints and disputes, for example, those involving costs.[39] In other

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[33] Fully informed consent will require that the client be alerted specifically to the disadvantages of a transaction involving a conflict of interest and may even require that the client be independently counselled: *Law Society of NSW v Harvey* [1976] 2 NSWLR 154; *Woods v Legal Ombudsman* [2004] VSCA 247.

[34] *Regal (Hastings) Ltd v Gulliver* [1942] 1 All ER 378.

[35] Eg ss 3 & 177 *Legal Practice Act 2003* (WA); s61 *Legal Profession Act 1993* (Tas); s75 *Legal Practitioners Act 1981* (SA).

[36] Available at http://www.lawcouncil.asn.au/policy/1957352449.html [accessed February 17th 2006].

[37] The Model Rules have been adopted in Victoria, South Australia, Australian Capital Territory, Northern Territory, New South Wales and Western Australia.

[38] S711 *Legal Profession Act 2004* (NSW); s223 *Legal Profession Act 2004* (Qld); s3.2.17 *Legal Profession Act 2004* (Vic).

[39] S4.2.5 *Legal Profession Act 2004* (Vic); s256 *Legal Profession Act 2004* (Qld); s505 *Legal Profession Act 2004* (NSW).

jurisdictions, low-level complaints are dealt with by professional committees or boards,[40] which may or may not include lay observers and/or government appointees. If the issues raised are serious and likely to result in significant penalty, such as a compensation order or suspension from practice, the complaint will be referred to a disciplinary tribunal.[41] Following a hearing and report, the tribunal may refer very serious matters, including disbarment proceedings, to the Supreme Court,[42] which is also empowered to exercise supervisory jurisdiction over the tribunal. The Supreme Court's inherent power to exercise first instance jurisdiction over applications to remove legal practitioners from the roll of legal practice is also retained.[43]

In relation to litigation funding, the article is most concerned with the regulation of potential conflicts of interest in the tripartite relationship between claim holder, litigation entrepreneur and legal practitioner. Generally there are two forms of conflict of interest that affect legal practice:

> Where the legal practitioner has a personal interest in the client's matter
>
> Where the legal practitioner's loyalty to a client is undermined by conflicting duties to other clients

Unless the litigation funder retains the legal practitioner, the funder does not fall within the definition of 'client' set out in the Model rules,[44] nor is the funder a client under general law principle.[45] Model Rule 8, which deals with conflicts between clients and sets out specific disclosure and consent requirements, therefore, does not

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40 S164 *Legal Practice Act 2003* (WA); s61 *Legal Profession Act 1993* (Tas); s74 *Legal Practitioners Act 1981* (SA); s47 *Legal Practitioners Act* (NT); s58 *Legal Practitioners Act 1970* (ACT).

41 S172 *Legal Practice Act 2003* (WA); s4.4.15 *Legal Profession Act 2004* (Vic); s69 *Legal Profession Act 1993* (Tas); s80 *Legal Practitioners Act 1981* (SA); ss276 & 280 (4) *Legal Profession Act 2004* (Qld); s50 *Legal Practitioners Act* (NT); s551 *Legal Profession Act 2004* (NSW). There is no separate tribunal in the ACT. The professional board acts as a tribunal.

42 S194 *Legal Practice Act 2003* (WA): s4.4.17 *Legal Profession Act 2004* (Vic); s69 (2) *Legal Profession Act 1993* (Tas); s89 Legal Practitioners Act 1981 (SA); ss280 (2) & 281 *Legal Profession Act 2004* (Qld); s50 (4AA) *Legal Practitioners Act* (NT); s62 *Legal Practitioners Act 1970* (ACT). In New South Wales, the Disciplinary Tribunal is empowered to suspend and disbar legal practitioners without referral to the Supreme Court: s562 *Legal Profession Act* 2004.

43 S161 *Legal Practice Act 2003* (WA); s4.4.39 *Legal Profession Act 2004* (Vic); s80 *Legal Profession Act 1993* (Tas); s89 (3) *Legal Practitioners Act 1981* (SA); s287 *Legal Profession Act 2004* (Qld); s52 *Legal Practitioners Act* (NT); s590 *Legal Profession Act 2004* (NSW); s67 *Legal Practitioners Act 1970* (ACT).

44 Eg Law Council of Australia, *Model Rules of Professional Conduct and Practice*, Definitions.

45 *Fostif Pty Ltd v Campbells Cash & Carry* (2005) 63 NSWLR 203 at [54]; *Project 28 Pty Ltd v Tim Barr Pty Ltd* [2005] NSWCA 240 at [70].

apply. As a result, the professional responsibilities of legal practitioners regarding conflict of interest between client and litigation funder are regulated by generalized duties of care and loyalty to the client,[46] by model rules dealing with conflicts of interest between the legal practitioner and client,[47] and by ordinary fiduciary principle.

Where the funder retains the legal practitioner and is not merely acting as the client's agent, the funder is also a client.[48] An analogy may be drawn between the funder and insurers who retain legal practitioners. In that case, the insurer and the insured are both clients, at least until a conflict of interest arises between them.[49] Where conflicts of interest do arise between insurer and insured, the legal practitioner owes a duty of undivided loyalty to the insured, unless that is modified by agreement.[50] Similarly where conflicts of interest arise between the funder as client and the client claim holder, the primary duty of the legal practitioner is to the client claim holder. Consequently, in addition to general duties of loyalty and care to the client, as between the client and the funder acting as a principal, the legal practitioner is subject to Model Rule 8.2 which provides,

> A practitioner must avoid conflict of interest between two or more clients of the practitioner or of the practitioner's firm.[51]

and to other fiduciary requirements related to conflicts of interest between clients.

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46 Eg Law Council of Australia, *Model Rules of Professional Conduct and Practice*, Rule 1.1 which provides:
'A practitioner must act honestly and fairly, and with competence and diligence, in the service of a client'.

47 Eg Law Council of Australia, *Model Rules of Professional Conduct and Practice*, Rule 9, which provides that the practitioner must not allow any personal interest to conflict with the interest of client, must not use undue influence upon the client for personal benefit and must not continue to act once a conflict of interest is manifested.

48 Indeed, in the *Fostif* matter the funder's agreement with the solicitor expressly provided as follows:
'Whilst you are acting for your client you have engaged me as principal and not as agent for your clients.'
See *Fostif Pty Ltd v Campbells Cash & Carry* (2005) 63 NSWLR 203 at [79].

49 *Groom v Crocker* [1939] 1 KB 194; *Brown v Guardian Royal Exchange Assurance plc* [1994] 2 Lloyd's Rep 325 (CA); *State Government Insurance Commission (SA) v Paneros* (1988) 48 SASR 349; *Mercantile Mutual Insurance (NSW Workers Compensation) Ltd v Murray* (2004) 13 ANZ Ins Cas 61-612.

50 *TSB Bank plc v Robert Irving & Burns (a firm) (Colonial Baltica Insurance Ltd, third party)* [2000] 2 All ER 826; *Mercantile Mutual Insurance (NSW Workers Compensation) Ltd v Murray* (2004) 13 ANZ Ins Cas 61-612.

51 Law Council of Australia, *Model Rules of Professional Conduct and Practice*, Rule 8.2.

Unlike litigation funders, lawyers are specifically exempted from Part 7 of the *Corporations Act 2001* (Cth), which deals with Financial Services Regulation (hereafter FSR). Section 766B(5) provides that advice given by a lawyer in a professional capacity about matters of law, legal interpretation or the application of law or any other advice given by a lawyer reasonably necessary to be given in the ordinary course of activities as a lawyer is not financial product advice. Moreover, merely referring a claimholder to a litigation funder will not constitute providing a financial service.[52] Consequently, lawyers are exempt from the FSR provisions dealing with managing conflict of interests that apply to litigation funders discussed below.

The arrangements made between litigation funders, claim holders and legal practitioners vary in the degree of control exerted by the funder over the prosecution of the claim, and in relation to the nature of financial arrangements funders make with legal practitioners. Some funders may make separate financial arrangements with law firms that have the potential to conflict with their duties to their clients. For example, in the first *Clairs Keeley* case,[53] the Western Australian Supreme Court was concerned that a retainer agreement between the funder and solicitors for the lead plaintiffs in a class action provided for a discount of 20% in fees if the claim was unsuccessful and an uplift of 25% in fees if the claim was successful and the funder's costs and expenses were reimbursed. Following criticism of this arrangement by the first instance judge, the cost agreement was varied so that the funder bore the burden of the 25% in uplift fees. However, neither the original costs agreement nor the variation was disclosed to clients. The Full Court found that the failure to disclose constituted a breach of the legal practitioners' fiduciary duty to their clients and raised a significant conflict of interests between the funder and the clients.[54]

None of the Australian professional litigation funders approached by the author retain legal practitioners as clients.[55] Nor do they have independent financial arrangements with legal practitioners outside of their tripartite agreement with claim holders. However, obviously, without their support the matter would not proceed. In

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52 *Corporations Regulations* 7.6.01 (1)(e).

53 (2003) 28 WAR 139.

54 Ibid at [162 - 170] per Templeman J. According to Templeman J, even though the funder bore the burden of the uplift fee, this placed it in a position of conflict with the clients, because the commercial basis for settling or proceeding with the matter (the funder was thereby exposed to larger legal fees) thereafter became different for the funder when compared to the clients. Subsequently full disclosure was made and the stay of proceedings which was initially granted was lifted: see *Clairs Keeley (a firm) v Treacy & Ors* [2005] WASCA 86.

55 Appendix Questions 7 & 8. Other funders may retain lawyers directly where delegated complete control of the claim prosecution: see *Project 28 Pty Ltd v Barr* [2005] NSWCA 240.

funded proceedings, although the legal practitioner may be solely employed by the claimholder, the legal practitioner is beholden to the litigation funder for the payment of client legal fees and has an incentive to please the litigation funder in order to attract repeat work.[56] In some cases the litigation funder may even appoint the claim holder's legal advisers and representatives.[57] Further all Australian litigation professional funders maintain a strong consultative role in claim management. The economic dependence of the lawyer upon the funder and the funder's desire to monitor and control its investment therefore have the potential to detract from the lawyer's client centred focus.

Additionally, a number of funding agreements require that legal practitioners acknowledge that both a duty of care and a fiduciary duty are owed to the funder as well as the client.[58] Breach of common law and fiduciary duties to funders is likely to lie outside of compulsory professional indemnity insurance cover.[59] Consequently, the increase in the legal practitioner's exposure to liability is likely to generate a further source of conflict.

Whether there is a direct retainer between funder and legal practitioner or not, conflicts can therefore arise with respect to:

- The strategies employed to pursue the claim. For example, a litigation funder may not wish to finance interrogatories whereas the client and legal practitioner may wish to pursue this option.
- Settlement. A litigation funder may want the client to accept what it regards as a reasonable offer of settlement, but the client wishes to pursue the matter. By continuing to pursue the matter the client places the litigation funder's investment in the claim at risk because costs may not be recoverable, the funder may find itself exposed to an adverse costs order even where it has withdrawn financial support, and the success fee or profit for the funder will be less if the case proceeds to judgment and judgment falls below the sum offered. Alternatively, a client may wish to settle too cheaply for the funder to make sufficient profit from its investment. This conflict can arise because the client is not necessarily motivated by claim maximization, whereas claim maximization is the funder's primary motivation.

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56 Even though most litigation funders do not appoint the client's legal advisers and representatives, they are likely to be influential in the client's decision making. Some funders work with preferred firms partly to minimise conflicts and disputes over claim management. See the discussion at 8.3 below and the Appendix Questions 7 & 8.

57 This occurred in *Campbells Cash & Carry Pty Ltd v Fostif Pty Ltd* (2006) 229 ALR 58.

58 MacDermott B 'Litigation Funding Risks' (2006) 44 (2) *Law Society Journal* 40, 40.

59 Ibid at p41.

- Settlement offers in kind rather than cash. The defendant(s) may offer to settle the claim(s) with offers of products or assets, which, while valuable to the claim holder, are of no value to the funder. To recoup their investment at reasonable cost funders will most likely only want a settlement in cash or in a form that can be readily converted to cash.
- Withdrawal. A client may wish to withdraw from proceedings because of ill-health or because of a desire to rehabilitate his or her relationship with the defendant. If proceedings are withdrawn, the litigation funder will not be in a position to recoup its investment.
- Confidential information. The lawyer may receive information from the client that could cause the litigation funder to exercise its right to unilaterally withdraw funding. By passing on this information to the funder the lawyer would be breaching client confidentiality.[60] By not passing on the information, the lawyer may be breaching contractual obligations to the funder. Alternatively, a legal practitioner acting for a claim holder may feel that the best method of convincing a defendant to settle is to disclose the forensic investigations and case evaluations undertaken by the funder. For reasons of commercial confidentiality the funder may oppose such disclosure.

All of the above situations require the exercise of judgment by legal practitioners when advising and/or representing the claimholder in negotiations and litigation. Even assuming legal practitioners' conscious motivation to act in the claimholder's best interests, perceptual and cognitive limitations may inhibit their ability to do so. When exercising judgment, lawyers, as much as the average person, rate themselves as more objective than other people and tend to see themselves as more moral, ethical and trustworthy than everyone else.[61] However, in reality perceptions about the capacity to be objective and to act ethically are distorted by an inclination to be self-regarding. Unfortunately all of us, including lawyers, are deluded by our perceptions of objectivity and ethicality into justifying self-interested decision making on the

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[60] Law Council of Australia, *Model Rules of Professional Conduct and Practice*, Rule 3 provides that the legal practitioner must not disclose a client's confidential information unless authorised by the client, compelled by law to disclose, to prevent the commission or concealment of a criminal offence, or where the information has lost its confidentiality. See further *Oceanic Life Ltd v HIH Casualty & General Insurance* (1999) 10 ANZ Ins Cases 61-438 regarding the duty of legal practitioners to maintain client confidentiality vis-à-vis their insurers in the absence of specific authorisation.

[61] Chugh D, Bazerman MH & Banaji MR 'Bounded Ethicality as a Psychological Barrier to Recognizing Conflicts of Interest' in Moore D, Cain DM, Loewenstein G & Bazerman MH (eds) n5 at p81.

basis of a distorted perception of fairness.[62] Individually lawyers cannot possibly all be more objective, moral or ethical than other groups of people.

At the same time, as a result of information asymmetry, clients are heavily dependent upon their lawyers to behave ethically and objectively and are likely to be significantly influenced by the perception of professionalism their lawyers project. The combination of client vulnerability and lawyers' illusion of the self as inherently ethical and honest results in 'bounded ethicality', which may unconsciously affect the quality of the lawyer's judgment and decision making.[63] In other words, even if lawyers consciously regards themselves as acting in their client's best interest when advising to settle a matter or to proceed to trial, unconsciously economic dependence on a funder has the potential to colour their advice to clients. Nonetheless, as a fiduciary and under the Model Rules, where conflicts arise, legal practitioners' independent judgment must remain unfettered and loyalty to the client must remain undivided.[64]

The primary means to deal with conscious as well as unconscious breaches of the duty of loyalty are:

- To resign and act for neither party;
- To make full and frank disclosure to the client of the conflict and to seek the client's permission to continue to act despite the conflict; or
- To agree with the client to waive strict fiduciary obligation

The first two options are reflected in Model Rule 8, which is aimed at preventing and addressing conflicts between clients who might constitute parties to the same transaction and in relation to the maintenance of confidentiality between clients with opposing interests.[65] Consequently, they are not readily transposable to conflicts between litigation funders and clients, where the conflict might be more properly characterized as between the legal practitioner and the claim holder. Nor are they feasible options. All lawyers are potentially conflicted and therefore none would qualify to act following resignation or following a client's decision to terminate the retainer after disclosure of a conflict.

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62 Ibid at p83.

63 Ibid at pp74 – 95.

64 Dal Pont GE n5 at p73; Ross Y n7 at p43; Cranston R (ed) *Legal Ethics and Professional Responsibility* [Oxford: Clarendon Press, 1995] at pp12 – 19; Lewis GD & Kyrou EJ *Handy Hints on Legal Practice* 2nd ed [Sydney: Law Book Co Ltd, 1993] at p31.

65 Law Council of Australia *Model Rules of Professional Conduct and Practice*.

The third option is the only practical means for legal practitioners to comply with their fiduciary obligations to their clients when legal fees are being paid by a funder. For this reason litigation funding agreements characteristically contain clauses providing the funder with the right to receive regular reports of progress, to be advised of any settlement proposal, and to have access to the client's file.[66] Agreements between the funder and legal practitioners also normally provide for budgeting approval requirements, sharing of information that the practitioner must give to the client in order to receive instructions, regular reports of progress, and top up professional indemnity insurance.[67] In addition, the funder usually reserves the right to unilaterally withdraw funding at any time.[68]

Nonetheless, the ability of legal practitioners to contract out of statutory duties of professional conduct may be limited by public policy concerns. A number of American courts have determined that insurer control over the conduct of a defence, in particular, budgetary approval for certain tasks, violates legal practitioners' duties of professional responsibility and is therefore contrary to public policy.[69] This is consistent with ethics rulings from some US State Bar Associations, which categorise insurer litigation guidelines as undue fetters on the attorney's discretion to mount a proper defence.[70] Directing legal practitioners to act in a manner deleterious to a

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66 See for example sample funding agreements from IMF available at http://www.imf.com.au/page.asp?content=funding [accessed 23rd February 2006].

67 Ibid. If the funder controls the proceedings, arguably, it is vicariously liable in tort for liability to third parties arising from legal practitioner misconduct:

68 See Appendix Question 13.

69 For example:
Hawaii
Finley v Home Insurance Co 975 P 2d 1145 (1998)
Kentucky
American Insurance Ass'n v Kentucky State Bar 917 SW 2d 568 (1996) – contract between lawyer and insurer whereby lawyer would do all insurer's legal work for a set fee prohibited. But note that this is not the case in Utah: Utah State Bar Ethics Opinion No. 02 – 03 available at 2002 WL 340262 or Texas Supreme Court of Texas, Professional Ethics Committee Op 542 available at 2002 WL 405093.
Montana
In the Matter of the Rules of Professsional Conduct and Insurer Imposed Billing Rules and Procedures: Ugrin, Alexander, Zadick & Higgins and James, Gray Bronson & Swanberg 2 P3d 806 (2000)

70 Eg Utah State Bar Ethics Advisory Opinion 02 – 03 available at 2002 WL 340262; Oregon State Bar Association Board of Governors Ethics Opinion 2002 – 166 available at 2002 WL 32062455; The Supreme Court of Ohio Board of Commissioners on Grievances and Discipline Op 2000-03 available at 2000 WL 1005223; Supreme Court of Texas Professional Ethics Committee Op 533 available at 2000 WL 987291.

client's interests may also violate express or implied duties of good faith between the funder and the client.[71]

Yet provided clients give full and informed consent to the attenuation of their legal practitioner's fiduciary duty it seems illogical to prohibit reporting and advisory procedures and the use of cost management techniques by funders of the same kind that affluent repeat player clients might themselves employ. Affluent repeat players like insurers and government make use of tender procedures to keep the cost of legal services low.[72] They also subject their legal advisers and counsel to budgetary capping, approval procedures for non-budgeted services and expenses and flat fees for certain tasks.[73] Regular reporting to in-house counsel or senior management is de rigueur. Why should not non-repeat, smaller value clients be able to delegate some of the control over their legal advisers that they are prevented by information asymmetry or poor bargaining power from exercising themselves to another party with expertise in litigation management who is likely to value-add to the process of claim prosecution? Permitting funders to extract efficiencies in the delivery of legal services will generally promote rather than harm client interest, whereas prohibiting the use of cost control techniques smacks of legal professional income maintenance.

Even so, there may be some point at which waiver of fiduciary duty to the client claimholder becomes contrary to public policy. This may occur where the client becomes the nominal claim holder only without any right to be consulted regarding the institution of proceedings, settlement, or other fundamental matters that run contrary to client interests. At the Court of Appeal in *Fostif*, although the Court was prepared to accept that a funder could maintain day-to-day control over claim prosecution, had the solicitor on record fully abdicated his obligation to faithfully represent the lead plaintiffs, Mason P intimated that this would be contrary to public

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However see Pennsylvania Bar Association Committee on Legal Ethics and Professional Responsibility Op 01 – 200 available at 2001 WL 1744775 determining that compliance with an insurer's litigation guidelines is ethical provided the implications for the defence of the action are properly communicated to the client and the client consents.

71 See discussion below. Pickering MH 'Conflicting Duties in Claims Investigation and Management' (1989) 2 *Insurance Law Journal* 1 at pp6 – 7 argues that waiver of the solicitor-client relationship in an insurance policy would be unenforceable because it would breach s14 *Insurance Contracts Act 1984* (Cth) which provides that if reliance on a provision of a policy would cause a party to fail to act with utmost good faith, the party may not rely on that provision.

72 Eg see the following request for tender at the Commonwealth Attorney-General's website: http://www.ag.gov.au/agd/WWW/agdHome.nsf/Page/RWPE7738519A8FDADDACA25711A007EB29E [accessed 24th February 2006].

73 Australian Law Reform Commission Report No. 89, *Managing Justice* [Canberra: AGPS, 2000] at p279 para 4.66.

policy.[74] When making these statements, Mason P referred to the anti-commodification of legal claims (rather than the scope of legal practitioners' fiduciary duty to clients) as the relevant public policy rationale. According to Mason P funders should be able to exert the same degree of control as insurers over the conduct of proceedings and in relation to settlement so long as this was consistent with the client's ultimate ownership of the claim and did not result in harm to the client's interests.[75] On the facts, the Court of Appeal found that the solicitor had maintained communication with clients on key issues and no conflicts or perceived conflicts of interests between the funder and the clients had arisen.[76] Later the majority of the High Court did not demur to these findings.[77]

The arrangements in *Project 28 Pty Ltd v Barr*,[78] where absolute control of the litigation was granted to the funder rather than the claim holder went much further than those in *Fostif*. In *Project 28 Pty Ltd v Barr*, the solicitors on record had no retainer or other legal relationship with the claim holder. The funder appointed and instructed the solicitors. In fact, the claim holder was prohibited from instructing the solicitors without the funder's written consent. Further, although the claim holder had a right to be consulted in relation to settlement, it was not necessary for the claim holder to consent to any settlement negotiated by the funder with the defendant. The claim holder was prohibited from undertaking any action in relation to the proceedings without the funder's written consent, which the funder was entitled to withhold at its absolute discretion.

Although, the New South Wales Court of Appeal was primarily concerned with abuse of process rather than public policy related to the statutory and fiduciary obligations of legal practitioners, Ipp JA felt that delegation of complete control was not improper. Like Mason P earlier in *Fostif*, in reaching his conclusion, Ipp JA also referred to insurance case law and practice. His Honour noted that the law had already countenanced insurers' absolute control over proceedings on the ground that that control was tempered by a duty on the part of the solicitors and the insurers to conduct the proceedings with due regard to the nominal claim holder's interests.[79] In the instant case, Ipp JA found that the funder had retained a reputable firm of

74 *Fostif Pty Ltd v Campbells Cash & Carry Pty Ltd* (2005) 63 NSWLR 203 at [85]
75 Ibid at [82].
76 Ibid at [84] – [86].
77 *Campbells Cash & Carry Pty Ltd v Fostif Pty Ltd* (2006) 229 ALR 58 at [63] per Gummow, Hayne & Crennan JJ.
78 [2005] NSWCA 240.
79 Ibid at [70] – [72].

solicitors and there was nothing to suggest that the case would be conducted improperly.[80]

Thus, although any conclusion regarding public policy and legal practitioners' duties to clients based on *Project 28 Pty Ltd* must remain tentative,[81] it seems that professional misconduct will only occur if the funder's conduct of proceedings leads to actual harm to a claim holder's interests. Otherwise arrangements sidelining the claim holder to a nominal party only do not negate legal practitioners' duties to their clients.[82]

Assuming future courts considering legal practitioners' fiduciary duties to funded clients will continue to apply the insurance analogy, the ethical conundrums previously outlined might be resolved as follows:

- Strategies. Provided the claim holder consents, like an insurer, the funder should be able to determine the strategies the parties will employ to maximize claim value. Under such an arrangement, legal practitioners will not be breaching statutory or fiduciary duties of professional conduct to their clients, provided that the clients, like the insured, give proper consent. Proper consent requires that clients be privy to all terms of any agreement between the funder and the legal practitioner, especially in relation to costs and success fees.
- If the claim holder has delegated management of the claim to the funder then day-to-day disputes over strategy are unlikely to arise. Where substantial harm to a claim holder's interest may occur, caution dictates that the appointed legal practitioner ensures that the claim holder is notified and advised to obtain independent advice for the claim holder's consent to funder control of proceedings to continue to be effective.[83]

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80 Ibid at [83].

81 The case was concerned with the issue of abuse of process, rather than statutory duties of professional conduct.

82 Delegation of complete control may, however, still amount to de facto assignment and facilitate trafficking in legal claims, which remains contrary to public policy.

83 Although insurance policies permit insurers to conduct proceedings in the name of the insured, should an actual and substantial conflict of interests arise between the insured and the insurer, the solicitor defending the claim on the instructions of the insurer should advise both the insured and insurer to obtain independent advice: *Kennedy v Cynstock Pty Ltd* (1993) 3 NTLR 109; *Verson Clearing International v Ward* (1996) 9 ANZ Ins Case 61-352; *TSB Bank Plc v Robert Irving and Burns* [2000] 2 All ER 826.

- If the claim holder maintains control of the proceedings and disputes arise over strategy[84] that cannot be resolved, the legal practitioner is obliged to carry out the claimholder's instructions. Thereafter, the funder may or may not exercise its right of unilateral withdrawal of funding.
- If the claim holder and the funder have jointly retained the legal practitioner, and the conflict is severe and cannot be resolved between the parties, the legal practitioner should resign and refuse to act for both the claim holder and the funder,[85] unless the claimholder has expressly consented to the legal practitioner continuing to act following a termination of the claimholder's retainer.[86]

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[84] Such a situation is hard to envisage in the professionally funded litigation context. In general the professional funder's interests and the claim holder's interests are aligned vis-à-vis strategy ie each seeks the adoption of strategies that maximise claim value. However if a professional litigation funder is not involved and the funder has other motives for financing the suit, for example, to gain a competitive advantage over the defendant as in *Volpes v Permanent Custodians Ltd* [2005] NSWSC 827, the incentives for adopting certain strategies may differ. For example, a funder competitor may want maximum media coverage of the proceedings to embarrass the defendant whereas a claimholder may want a litigated result without much media exposure.
Alternatively, a claim holder may wish to pursue strategies that a funder regards as contrary to claim maximisation. For example, a claim holder may wish to subpoena witnesses employed by a defendant to confront them rather than because they necessarily further the case in an efficacious manner. Alternatively, the claim holder may wish to employ a particular expert, even though the funder believes that there are more highly qualified and persuasive experts available or that no expert is required.

[85] For example, the funder may wish to enforce contractual rights against the client relating to warranties and change of position clauses following the termination of their relationship.

[86] In the insurance context, where a conflict arises between the insured and insurer, solicitors jointly retained by both should terminate their retainer with the insurer and advise the insurer to seek legal advice and representation from another law firm: *Verson Clearing International v Ward & Prs* (1997) 9 ANZ Ins Cas 61-352; *ACN 007 838 584 Pty Ltd v Zurich Australian Insurance Ltd* (1997) 69 SASR 374; *Oceanic Life Ltd v HIH Casualty & General Insurance* (1999) 10 ANZ Ins Case 61-438. However that position can be modified by agreement. Mills M 'Risks and Remedies for Conflicts of Interest – Perspectives of an Insurer's Lawyer' (1999) 10 *Insurance Law Journal* 167 argues that retainer agreements between a solicitor and insured can, provided they are sufficiently explicit and properly explained to the insured, be drafted such that if a conflict arises between the interests of the insurer and the insured, the firm will cease to act on the insured's behalf and may continue to act on behalf of the insurer in relation to any dispute between the insured and the insurer concerning the scope of indemnity. However no specific authority is cited to support this proposition, apart from United States cases dealing with reservation of rights clauses permitting insurers to continue to instruct counsel vis-à-vis the conduct of a defence, without loosing the right to dispute indemnity at a future date.

- Settlement. Legal practitioners' duties to claim holders qua funders will vary according to the terms of their funding agreement and the terms of the legal practitioner's retainer. Most litigation funding agreements contain clauses dealing with settlement.[87] These require that the funder be notified and consulted regarding settlement proposals. In some cases, the funding agreement may require the funder's consent to any settlement.[88] If a conflict arises between the funder and the claim holder over settlement, again, most funding agreements make provision for dispute resolution.[89] Typically this will involve expert adjudication from Senior Counsel. The expert opinion may be binding[90] or non-binding.[91]
- Whether Senior Counsel's opinion is binding or non-binding, legal practitioners may face a conflict if the claim holder does not agree with the opinion. For example, although the claim holder may be contractually bound by Senior Counsel's opinion, will the legal practitioner's advice regarding the enforceability of a binding dispute resolution clause[92] be affected by the funder's payment of the legal practitioner's fees? If the claimholder is not bound by Senior Counsel's opinion will the legal practitioner's advice to the claim holder regarding the soundness of the opinion be affected if this is contrary to the funder's position on the matter?
- Despite the potential for conflict, if Senior Counsel has determined that a settlement is either inadequate or reasonable and the client does not wish to abide by that opinion it is difficult to determine what losses might flow to the claimholder if the legal practitioner fails to comply with the client's wishes or persuades the client to change his or her mind and follow Senior Counsel's advice. If a settlement offer is inadequate and the claim holder wishes to accept it, but is persuaded by the legal practitioner to press on, what could the claim holder claim as its loss when damages awarded by the court or another future settlement offer are considerably greater than the original offer? The client's loss may actually be minimized if the funding agreement contains a fee escalation clause should settlement be completed too cheaply.[93] Similarly, if Senior Counsel opines that an offer is reasonable and the claim holder, after initial reluctance, is

87 See Appendix Question 11.
88 Appendix Question 7 Funder E.
89 Ibid.
90 Eg Appendix Question 11 Funders B, C & D.
91 Eg Appendix Question 11 Funders A & E.
92 Eg is it unconscionable or contrary to an express or implied duty of good faith to enforce the provision in the circumstances that have arisen?
93 Eg Appendix Question 11 Funder C.

persuaded by the legal practitioner to accept the offer, what loss could the claim holder claim against the legal practitioner in the absence of a significantly higher judgment?

- It may be possible to argue that breach of fiduciary duty does not necessarily require proof of harm to the claim holder's interests. Instead the claimholder make seek other relief such as restitution of a conditional uplift fee. Nevertheless, breach will also be difficult to prove if the legal practitioner recommends a course of action based upon Senior Counsel's learned opinion unless it can be shown that the legal practitioner was aware that Senior Counsel's opinion was fraudulent or otherwise faulty. For the same reasons, disciplinary action based upon a breach of the statutory duty of professional conduct is unlikely to succeed.
- Although none of the funding arrangements discussed by the author with the professional litigation funders interviewed for the purpose of the thesis delegated complete authority to the funder to settle the matter on behalf of the claim holder,[94] such contractual arrangements are possible.[95] Despite the delegation of the power to settle a proceeding to a funder, insurance case law and practice suggests that legal practitioners must not settle on terms that harm the claim holder's interests, except where the claim holder has given properly informed consent.[96] For example, if contrary to a claim holder's wishes or absent consultation with the claim holder, the funder unreasonably rejects an offer of settlement in order to increase claim profitability, and final judgment is substantially less than the offer, the legal practitioner involved in an unreasonable pursuit of litigation would breach his or her duty to the claim holder[97] and breach his or her statutory obligations of professional conduct.[98] To

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94 Appendix Questions 7 & 11.

95 *Project 28 Pty Ltd v Barr* [2005] NSWCA 240 is an example.

96 *Groom v Crocker* [1939] 1 KB 194. For the client's consent to be properly informed, ideally the consequences of waiving the power to settle proceedings should have been carefully explained to the claim holder by an independent legal practitioner: see Mills M n86 at p171.

97 The duty to the claim holder arises because the claim holder is the party on record in the litigation conducted by the legal practitioner whether or not the claim holder has retained the legal practitioner: *Groom v Crocker* [1939] 1 KB 194;*Brown v Guardian Royal Exchange Assurance plc* [1994] 2 Lloyd's Rep 325 (CA); *State Government Insurance Commission (SA) v Paneros* (1988) 48 SASR 349; *Mercantile Mutual Insurance (NSW Workers Compensation) Ltd v Murray* (2004) 13 ANZ Ins Cas 61-612. See further Pickering MH n71 at p5.

98 See, for example, *Rogers v Robson, Masters, Ryan Brumund and Belom* 74 Ill App 3d 467; 392 NE 2d 1365 (1979). An insurer's lawyers rejected an offer to settle for the policy limit. Unreasonably, the insurer's lawyers believed that the plaintiff would be forced to settle for a lesser sum as a result of insufficient funds to litigate the case to judgment. On the face of

avoid breach, the legal practitioner should obtain independent advice from Senior Counsel regarding the adequacy of all sensible offers of settlement and act accordingly.

- Withdrawal. If the client claim holder wishes to withdraw from the proceedings, the legal practitioner is obliged to obey the client's wishes and terminate the prosecution of the claim as soon as practicable. Any arrangement between the legal practitioner and the funder should also end as a result, subject to arrangements to pay accruals.
- Where the funder retains the legal practitioner and not the claimholder, and the claimholder wishes to withdraw, the legal practitioner should direct the claim holder to independent legal advice.
- If the funder and claimholder jointly retain the legal practitioner, the legal practitioner may be forced to resign and act for neither party, unless the claim holder has agreed that the legal practitioner may continue to act following a termination of the claimholder's retainer.
- Confidential Information. Typically the client agrees to share all pertinent information with the funder on a confidential basis.[99] Arguably this overrides any fiduciary obligation that a legal practitioner might owe to their client vis-à-vis confidentiality between the client and the funder, notwithstanding that the sharing of information may cause the funder to withdraw its funding of the proceedings.[100] However, such clauses need to be drafted carefully in order to

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it, the settlement offer was objectively reasonable. The defendant had no material defence to the plaintiff's claim. The plaintiff persevered and obtained a judgment for double the sum offered to settle. Both the insurer and the insurer's lawyers were successfully sued by the insured.

99 See for example sample funding agreements from IMF available at http://www.imf.com.au/page.asp?content=funding [accessed 23rd February 2006].

100 Insurance cases support this proposition: *SGIC (SA) v Paneros* (1989) 5 ANZ Ins Cas 60-940 – solicitors obliged to pass on admissions about drink driving to an insurer notwithstanding that the insurer was entitled to recover adamages it had awarded injured persons if the driver was drink driving; *Brown v Guardian Royal Exchange Assurance Plc* [1994] 2 Lloyd's Rep 325 (CA) – solicitors under a duty to report regarding matters learned from client concerning defence of claim. Any admissions made by the defendant to solicitors regarding negligence or fraud therefore had to be passed onto the insurers. However if there is no explicit authorisation or duty to report, the solicitor should not pass on any information after an actual conflict emerges: *TSB Bank Plc v Robert Irving & Burns* [2000] 2 All ER 826 (CA); *Nicholson v Icepak Coolstores Ltd* [1999] 3 NZLR 475.

make it clear that the client waives legal professional privilege over information generated for the purpose of the proceedings or for legal advice qua the funder.[101]

- Public policy more strongly favours disclosure of information to the funder that may cause it to reconsider its position than it might favour disclosure of information to an insurer that would cause the insurer to decline to indemnify the insured.[102] Proceedings should not be funded, and the funder exposed to potential liability for abuse of process or contempt,[103] if information emerges that throws doubt on the validity or viability of the claim. One of the most significant benefits of litigation funding is the commercial objectivity funders bring to claim evaluation.[104] Such objectivity should be supported by continued encouragement of full and frank communication between funder, claim holder and legal practitioner, even where conflicts of interest might arise.
- Funding agreements do not typically refer to the ownership or sharing of information generated by the funder such as reports of forensic investigations or case evaluations. Such material generated by the funder is not usually subject to legal professional privilege;[105] nonetheless it would be protected by the equitable doctrine of confidentiality.[106] Disclosure to the claim holder and legal practitioner on a limited basis is not likely to waive confidentiality.[107] As a result, the funder would be within its rights to restrain disclosure of any forensic investigation or claim evaluation to third parties.

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101 See *Nicholson v Icepak Coolstores Ltd* [1999] 3 NZLR 475 where Penlington J of the New Zealand High Court found that a contractual obligation upon the insured to supply information to the insurer to facilitate defence of a claim was insufficient to negate the insured's legal professional privilege in instructions given to a solicitor appointed by the insurer.

102 Arguably matters, which affect the insurer's indemnity obligations should be disclosed to deter insurance fraud.

103 See discussion below.

104 See comments of French J in *QPSX Ltd v Ericsson Australia Pty Ltd* (2005) 219 ALR 1 at [54].

105 Either because it is brought into existence prior to the solicitor's retainer with the client, or because it is not brought into existence for the dominant purpose of facilitating legal advice or legal work product. Rather, the material is brought into existence for the dominant purpose of determining whether the funder should finance the claim: *Esso Australia Resources Ltd v Federal Commissioner of Taxation* (1999) 201 CLR 49.

106 *Coco v AN Clark (Engineers) Ltd* (1969) RPC 41; *Ansell Rubber v Allied Industries* [1967] VLR 37.

107 *Lac Minerals Ltd v International Corona Resources Ltd* (1989) 2 SCR 574.

The relationship between claim holder and litigation funder

Although development of practice in the litigation funding industry is relatively embryonic, as foreshadowed in the article's introduction, there are two apparent models of relationship operating between claim holder and litigation funder.

1. The first model involves the delegation of complete control of the claim to the funder, either through the mechanism of agency or by some other means. The relationship between funder and claim holder under this model has similar features to the relationship between insurer and insured pursuant to common law, statutory and contractual rights of subrogation.[108]

2. Under the second model, the claim holder maintains control of the conduct of the claim and directly retains and instructs the legal practitioner. The principal-agent archetype cannot be transposed to this kind of relationship. Nor is the relationship between claim holder and litigation funder under this second model simply a debtor and creditor relationship. The funder is an investor in the claim, and unlike passive shareholders in large public companies, is a careful monitor of its interests,[109] and in some cases exerts considerable influence over claim management.[110] Depending on the level of the funder's participation in claim management, the relationship between

[108] In effect, subrogation means that the insurer is placed in the shoes of the insured regarding the pursuit of claims against third parties: Sutton K *Insurance Law in Australia* 3rd ed [Sydney: LBC Information Services Ltd, 1999] at p1220. Under the doctrine of subrogation:

The insurer can pursue any claim belonging to the insured which may diminish the insured loss

The insured is liable to account to the insurer for any compensation received so as to recoup the provision of the indemnity provided

Subrogation applies by operation of law, whether or not there is specific provision for subrogation in the insurance contract: *Castellan v Preston* (1883) 11 QBD 380 However subrogation only applies by operation of law to contracts of indemnity: *British Traders' Insurance Co Ltd v Monson* (1964) 111 CLR 86, 94 – 95. Otherwise a specific contractual agreement is required. Subrogation applies whether the insurance is first or third party insurance.

[109] Berle A & Means G *The Modern Corporation and Private Property* [New York: Macmillan, 1932]; Demsetz H 'The Structure of Ownership and the Theory of the Firm' (1983) 26 *Journal of Law and Economics* 375; Hart O 'Corporate Governance: Some Theory and Implications' (1995) 105 *The Economic Journal* 678; Stapledon GP *Institutional Shareholders and Corporate Governance* [Oxford: Clarendon Press, 1996] Ch 1.

[110] See appendix to this chapter.

> litigation funder and claim holder under this model is analogous to a joint venture.[111]

To consider the difference between the two models and to better understand the nature of the relationship between litigation funders and claims holders,[112] I undertook a study comprising a series of interviews with senior management personnel in litigation funding firms around Australia. Six funding firms were identified and approached to participate in the study. The firms were identified by reference to web searches for 'Australia litigation funding', from the Insolvency Practitioners Journal and Insolvency Practitioners website and from referral by other funders. Six interviews of approximately one hour's duration were conducted. Pursuant to ethical protocols[113] and by agreement with the participant firms, the identity of the interview participants and the attribution of their views remain

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[111] Joint ventures are contractual arrangements where the parties agree to cooperate in a business venture with a view to obtaining a share of the output or product according to the nature of their participating interest. However, unlike a partnership, there is no profit sharing and the parties are not responsible for each other's losses. Although joint venturers generally agree or impliedly agree to act in good faith towards each other, they are not fiduciaries. See further *United Dominions Corporation Ltd v Brian Pty Ltd* (1985) 157 CLR 1 Mason, Brennan and Deane JJ at 10:

'The term "joint venture" is not a technical one with a settled common law meaning. As a matter of ordinary language it connotes an association of persons for the purposes of a particular trading, commercial, mining or other financial undertaking or endeavour with a view to mutual profit, with each participant usually (but not necessarily) contributing money, property or skill. Such a joint venture (or, under Scots' law, "adventure") will often be a partnership. The term is, however, apposite to refer to a joint undertaking or activity carried out through a medium other than a partnership: such as a company, a trust, an agency or joint ownership. The borderline between what can properly be described as a "joint venture" and what should more probably be seen as no more than a simple contractual relationship may on occasion be blurred. Thus, where one party contributes only money or other property, it may sometimes be difficult to determine whether a relationship is a joint venture in which both parties are entitled to a share of profits or a simple contract of loan or a lease under which the interest or rent payable to the party providing the money or property is determined by reference to the profits made by the other.'

However note that in its standard form contracts, IMF (Australia) Ltd specifically disavows that the relationship it has with the claim holder is a joint venture. Sample contracts are available at http://www.imf.com.au/page.asp?content=funding [accessed 8th March 2006].

[112] The study undertaken also examined the relationship between litigation funders and legal practitioners.

[113] National Health and Medical Research Council, National Statement on Ethical *Conduct in Research Involving Humans* available at http://www.nhmrc.gov.au/publications/synopses/e35syn.htm [accessed 22nd February 2006].

confidential. A summary of the data collected for my study is contained in the Appendix to the article. References to the study appear throughout.

The Law Council of Australia is of the view that these two models are differentiated not just in form but also in substance and in operation. In a submission to the Standing Committee of Attorneys-General on Litigation Funding, the Law Council supported the requirement that there be a direct retainer between solicitor and client in funded representative actions.[114] The Law Council believed that without a direct retainer, funders might exert an improper influence over the conduct of the case. That position echoes views expressed by the majority of the Western Australian Supreme Court in the *Clairs Keeley* cases[115] and by the judge at first instance in the *Fostif* matter,[116] concerned with what they regarded as excessive control by funders over legal proceedings.[117]

Arguably the position articulated by the Law Council is a self-serving one because it tends to promote greater control by lawyers over litigation strategy and easier access to fees at the expense of those who finance the proceedings.[118] Legal practitioners make money by delivering and charging for legal services. The more services that are provided the larger the legal fees that can be charged. On the other hand, litigation funders want to ensure that the legal services provided to claim holders maximize claim value. Over servicing reduces claim value and also (from a litigation funder's perspective) impedes cash flow by delaying settlement or judgment. If the litigation funder's ability to control proceedings is superseded by a primary duty to the client, and clients are ineffective monitors of legal practitioners, the ability of the funder to ensure that claim value is being maximized is compromised.

The views expressed by the Law Council also contradict the practice of solicitors acting under 'no win no fee' agreements in the class action context, where

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114 Submission dated 6th October 2005. Not published. Copy held on file by author. The Law Council's submissions were subsequently incorporated in a Discussion Paper released by the Standing Committee of Attorneys-General, Litigation Funding in Australia, May 2006 available at http://www.lawlink.nsw.gov.au/lpd – [accessed June 14th 2006] at 3.2.

115 (2003) 28 WAR 139; (2005) 29 WAR 479.

116 *Keelhall Pty Ltd t/as "Foodtown Dalmeny" and 6 Ors v IGA Distribution Pty Ltd formerly known as Davids Distribution Pty Ltd & 3 Ors*, etc [2003] NSWSC 816 . This case is indexed in Austlii as *Marston v Statewide Independent Wholesalers Ltd* [2003] NSWSC 816.

117 However the position is contrary to the views expressed by the New South Wales Court of Appeal in *Project 28 Pty Ltd v Barr* [2005] NSWCA 240 and in *Fostif Pty Ltd v Campbell's Cash & Carry Pty Ltd* (2005) 63 NSWLR 203.

118 See Silver C 'When Should Government Regulate Lawyer-Client Relationships? The Campaign to Prevent Insurers from Managing Defense Costs' (2002) 44 *Ariz Law Rev* 787, 792 making a similar argument in respect of the legal profession's organized resistance to insurers' management of claims.

representative parties and group members are often obliged to cede substantial control of the proceedings to the class lawyer.[119]

It is also arguable that given funders reserve a right of unilateral withdrawal, and that their funding agreements with claim holders contain terms which allow them to monitor and assist in the direction of proceedings,[120] that the differences between the two models outlined are not as substantive as portrayed.

The type of claimholders who successfully enter funding agreements with professional litigation funders throws considerable light upon the nature of the relationship between funder and claimholder. All funders interviewed for the survey appended to this Thesis were unanimous that they would not invest in claims involving what one of them termed 'the human element'.[121] Funders were only interested in commercial matters involving no physical or mental injuries to the claimholder and avoided claims which otherwise might lead to a divergence in interests between them and the claimholder such as family law or defamation matters. Except for class action proceedings, claimholders were commercially sophisticated and often well-resourced or, as a result of the history of litigation funding in Australia, many were insolvency practitioners.[122]

Claimholders involved in representative proceedings, on the other hand, were less likely to be commercially sophisticated. Furthermore, while little effort appeared to be expended by funders to solicit individual claimholders,[123] generally much more effort was undertaken to attract 'clients' to representative proceedings. In one case, the funder outsourced the marketing of participation in a large representative proceeding to another specialist firm.[124] For these reasons and others associated with problems regarding multiple claim management, claim holders in representative proceedings are considered separately below. This section will largely focus upon the relationship between funders and individual clients.

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[119] See Grave D & Adams K *Class Actions in Australia* [Pyrmont, NSW: Lawbook Co Ltd, 2005] at 15.630. The authors discuss one typical no win no fee agreement from the *Bray v F Hoffman – La Roche* litigation where the group members were obliged to:

Abide by the solicitors reasonable advice

Continue with their claim unless advised otherwise by the solicitors

Continue to solely instruct the retained solicitors.

[120] See earlier discussion.

[121] Appendix Question 5 Funder D.

[122] Appendix Questions 3 & 5. Insolvency practitioners are commercially sophisticated and many are experienced litigators.

[123] Appendix Question 1.

[124] Appendix Question 3 Funder F.

The fact that individual claimholders are likely to be commercially sophisticated obviates the need for paternalistic intervention regarding the terms and conditions of funding agreements.[125] For many funded claim holders litigation is a part and parcel of doing business and like any other business risk it makes sense to share that risk with a litigation funder expert in claim evaluation and (in a number of instances) claim management and prosecution. While success fees of between 30 – 50%[126] may appear, from an outsider's perspective, to be profit gouging on the part of funders, sophisticated commercial operators are prepared to share their business risk at this price.

For similar reasons, if sophisticated commercial claimholders wish to delegate conduct of proceedings to funders it makes good business sense to allow them to do so. Litigation and claim management are stressful and impose high opportunity costs.[127] Furthermore, claim management and prosecution are likely to impose more marginal cost upon the claimholder than the funder, an experienced and knowledgeable claim manager with a diversified portfolio of claims.

Views from professional funders on the desired level of control over claim management were mixed. The majority was in favour of claimholders' continued ownership and ultimate control over fundamental matters such as settlement.[128] They were concerned that without continuing ownership and participation (albeit limited participation) claimholders' incentive to zealously pursue the claim would diminish.[129] Consequently, the majority of professional funders did not want further control over claim management other than the degree of control necessary to effectively monitor their investment. The desired degree of control necessary to

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125 See earlier discussion regarding regulation of litigation funding in Chapter 6.

126 Appendix Question 6.

127 Trubek DM, Sarat A, Felstiner WLF, Kritzner HM & Grossman JB 'The Costs of Ordinary Litigation' (1983) 31 *UCLA L Rev* 72, 90 –91; Cooter RD & Rubinfeld DL 'Economic Analysis of Legal Disputes and Their Resolution' (1989) 27 *Journal of Economic Literature* 1067, 1082; Galanter M 'The Day After the Litigation Explosion' (1986) 46 *Maryland Law Review* 3, 8 – 11: 'For plaintiffs and defendants alike litigation proves a miserable, disruptive and painful experience. Few litigants have a good time or bask in the esteem of their fellows – indeed, they may be stigmatised. Even those who prevail may find the process very costly.'

128 Appendix Question 18.

129 These views are consistent with concerns expressed Abramowicz M 'On the Alienability of Legal Claims' (2005) 114 *Yale L J* 697, 743 – 745. Those who were interested in buying claims (eg Funder C) would only do so at a heavy discount to off-set the risk associated with attempting to ensure the original claimholder's continued co-operation in claim prosecution. This further supports Abramowicz's view that the market for legal claims may be a market for lemons. Claimholders with strong claims are less likely to sell at heavily discounted values than those with weak claims.

monitor and protect their investment did, however, vary between funders along a continuum from regular reporting to almost total control over claim prosecution. At the lowest level of control,[130] monitoring consisted of regular reports of progress from the claimholders' legal advisers plus approvals for exceeding a global budgetary cap. In another case,[131] regular reports of progress from the claimholders' legal advisers were required against a budgetary framework incorporating set timelines and budgets for particular tasks in the claim prosecution. In an example of greater control, the funder was party to the claimholder's retainer and played a strong role in ensuring that the claimholder's legal practitioner performed to service levels, which the funder rather than the claimholder determined.[132] Greater control again was exerted by a funder, which in addition to the implementation of budgetary approval systems, monitored proofing of key witnesses and sat in on strategy meetings with the claimholder and legal practitioner.[133] One funder, undertaking claim investigation and evaluation, appointment of legal representation and the conduct of settlement negotiations on behalf of the claimholder exercised the highest level of control.[134] The last arrangement was causally related to the way in which the claimholder became involved with the funder. In that case, the funder had identified and developed the claim opportunity and approached potential claimholders seeking their involvement. The claimholders would not have pursued the claim themselves without the entrepreneurial intervention and encouragement of the funder. One other funder exerted a similar level of control apart from the appointment of legal representation and authority to conduct settlement proceedings because of its early involvement in claim investigation and evaluation.[135]

Although trends are difficult to identify with such a small number of funders, it seems that the earlier a funder becomes involved in claim development, that is, the greater its entrepreneurial role in identifying, investigating and evaluating the claim as a business project, the greater the degree of control that the funder is likely to exercise over claim prosecution and management. Conversely, if the funder becomes involved after or near the initiation of proceedings, it is more likely that the funder will exert less control and act as a banker to the claimholder. In the former case, although the claimholder may constitute the sole client of the legal practitioner, the claimholder is heavily reliant upon the funder to direct and manage proceedings. In other words, where the funder acts as an entrepreneur rather than as a banker, the

[130] Appendix Question 7 Funder A.
[131] Appendix Question 7 Funder D.
[132] Appendix Question 7 Funder E.
[133] Appendix Question 7 Funder B.
[134] Appendix Question 7 Funder F.
[135] Appendix Question 7 Funder C.

dividing line between a claim holder directly retaining legal representation and the funder retaining legal representation is very thin. The Law Council's insistence that the claimholder should directly retain the funder would not appear to prevent a funder exerting substantial control over the proceedings.

Where control by the funder is substantial many indicia of a fiduciary relationship are present. The claim holder is required to share confidential information with the funder, the claimholder reposes a considerable degree of confidence in the funder to maximize claim value, and the claimholder is vulnerable to abuse should the funder and legal practitioner collude to increase their profits at the claimholder's expense.[136] Nonetheless, entrepreneurial funders effectively conducting proceedings in the shoes of claimholders do not claim to be acting other than in their own self-interest and do not represent that they act for the benefit of the claimholder. It is doubtful that sophisticated commercial operators dealing with entrepreneurial funders would regard funders as other than fellow participants in claim investment acting for mutual advantage. When exerting control, the funder's purpose is clearly to monitor its own investment rather than to promote the claimholder's interests.[137] Both the funder and the claimholder are commercially sophisticated, have relatively equal bargaining power, and are legally advised.[138] For the same reason that insurers are not fiduciaries of the insured, it is unlikely that litigation funders are fiduciaries of claimholders.

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[136] Many of the indicia of fiduciary relationships are outlined in Parkinson P (ed) *The Principles of Equity* [Prymont, NSW: Lawbook Co Ltd, 2003] at pp 339, 346; Meagher RP, Heydon JD & Leeming MJ *Meagher, Gummow and Lehane's Equity Doctrines and Remedies* 4th ed [Australia: Butterworths LexisNexis, 2002] at pp157 – 160.

[137] According to Mason J in *Hospital Products Ltd v United States Surgical Corporation* (1984) 156 CLR 41 at 96-97: 'The distinguishing characteristic of a fiduciary relationship is that its essence, or purpose, is to serve exclusively the interests of a person or group of persons; or, to put it negatively, it is a relationship in which the parties are not each free to pursue their separate interests.'

[138] See *Paul Dainty Corp Pty Ltd v National Tennis Centre Trust* (1990) 22 FCR 495, 515
'The authorities make it clear that equity will not impose fiduciary obligations on parties who have entered into ordinary and arm's length commercial relationships, which fully prescribe the respective powers and duties of the parties. This is particularly so when the parties involved are substantial corporations having equal bargaining power.'
See further *Hospital Products Ltd v United States Surgical Corp* (1984) 156 CLR 41; *Elders Trustee & Executor Co Ltd v EG Reeves* (1987) 78 ALR 193, 238; *Kelly v CA & L Bell Commodities Corporation Pty Ltd* (1989) 18 NSWLR 248; *News Ltd v Australian Rugby Football League Ltd* (1996) 64 FCR 410, 542 – 51; *State of South Australia v Peat Marwick Mitchell & Co* (1997) 24 ACSR 231; *Truebit Pty Ltd v Westpac Banking Corporation* [1997] 1290 FCA; *Finding v Commonwealth Bank* [2001] 1 Qd R 168.

Of course, that does not necessarily foreclose the imposition of fiduciary obligation for some purposes or in some circumstances. Fiduciary obligations may apply to some aspects of a relationship but not others;[139] or may apply in particular circumstances as a result of the individual expectations of the parties regarding their mutual conduct.[140] Thus if circumstances were such that a claimholder's reasonable expectations were that the funder was acting in the claimholder's interests the funder might be subject to fiduciary obligation for a particular purpose or within the limit of those reasonable expectations. For example, when a claimholder shares confidential information with the funder, it would be contrary to the claimholder's reasonable expectations for the funder to use the confidential information for the benefit of the funder's other business interests.

The characterization of the relationship between funder and claimholder as non-fiduciary does not exclude the imposition of an implied duty of good faith in respect of the exercise of the funder's powers under the funding agreement either.[141] Although a funder may not be expected to sacrifice its own interests in favour of a claimholder as a fiduciary,[142] because of the high degree of reliance reposed in the

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139 *Noranda Australia Ltd v Lachlan Resources NL* (1988) 14 NSWLR 1.

140 *Commonwealth Bank of Australia v Smith* (1991) 102 ALR 453.

141 The implied duty of good faith in contract lacks precise definition. It includes (i) a duty to carry out the contract according to the original purposes for which it was made (ii) to avoid exploitation of a vulnerable party; (iii) a duty to regard the interests of each party to the contract and (iv) to use contractual powers reasonably. See further *Legione v Hateley* (1982–1983) 152 CLR 406 at p444; *Renard Constructions (ME) Pty Ltd v Minister for Public Works* (1992) 26 NSWLR 234 at pp267-269; *Alcatel Australia v Scarcella & Ors* (1998) 44 NSWLR 349 at pp363-369; *Burger King Corporation v Hungry Jacks Pty Ltd* [2001] NSWCA 187 at [141] - [187]; *Vodafone Pacific Ltd & Ors v Mobile Innovations Ltd* [2004] NSWCA 15 at [183] - [216]; *Hurley v McDonalds Australia Ltd* (2000) ATPR 41-741 at [21] - [31]; *Overlook v Foxtel* [2002] NSWSC 17 at [54] - [76]; *Far Horizons Pty Ltd v McDonalds Australia Pty Ltd* (2000) VSC 310 at [119] - [130]; *Esso Australia Resources Ltd v Plowman* (1994–1995) 183 CLR 10 at p30; *Byrne v Australian Airlines Ltd* (1995) 185 CLR 410 at pp447–453; *Breen v Williams* (1995–1996) 186 CLR 71 at pp102-103; *Peters (WA) Ltd v Petersville Ltd* (2001) 205 CLR 126 at [35] & [36]; *Service Station Association Limited v Berg Bennett & Associates Pty Limited* (1993) 45 FCR 84 at pp91-99; *Hughes Aircraft Systems International v Air Services Australia* (1997) 76 FCR 151 at pp191-193; *Australian Competition & Consumer Commission v CG Berbatis Holdings Pty Ltd* (2000) ATPR 41-755; *Garry Rogers Motors (Aust) Pty Ltd v Subaru (Aust) Pty Ltd* (1999) ATPR 41–703 at [34] - [39]; *Australian Competition and Consumer Commission v Simply No-Knead (Franchising) Pty Ltd* [2000] FCA 1365; *Pacific Brand Sport & Leisure Pty Ltd v Underworks Pty Ltd* [2005] FCA 288 at [61] – [66].

142 A strict duty of loyalty is a key component of fiduciary relationships. In a fiduciary relationship the principal is entitled to the single-minded loyalty of the fiduciary and the fiduciary must prefer the interests of the principal to his or her own interests. This goes further than the implied duty of good faith, which requires that the contracting parties regard the interests of each other as well as their own, in a spirit of co-operation. Under the

funder, it will be appropriate to impose a duty upon the funder to regard the interests of the claimholder as well as its own and to require the funder to act accordingly when exercising particular powers, for example, the power to negotiate settlement.

In *Project 28 Pty Ltd v Barr*,[143] Ipp JA unmistakably implied that funders ought to be subject to an implied duty of good faith in the same manner that insurers who, undertake proceedings pursuant to statutory or contractual rights of subrogation, are subject to a duty to regard the insured's interests when conflicts arise between them.[144] On that basis, if any of the conflicts outlined earlier do arise between funder and claimholder, the funder would be bound to ensure that the claimholder was properly notified and that its interests were effectively represented and respected. The dispute resolution clauses that a number of funding agreements contain are one means by which claimholder interests and funder interests in the settlement of proceedings can be fairly balanced.

To satisfy the requirement of notification and respect for claimholder interests, regular communication with claimholders regarding the progress of their claims is essential. One of the funders, who played a strong role in claim management, invested considerable resources into developing and implementing effective communication with claimholders.[145] The other entrepreneurial funder whose client base was typically small engaged in regular reporting and in one atypical class action, outsourced communication to a specialist firm.[146] Funders exercising less control relied more heavily on the claimholders' legal advisers to provide information on claim progress, although they also communicated with claimholders regularly, albeit on a less formal basis than a regular line of reporting.[147]

One major difference, however, between funders and insurers is that the duty of good faith is statutorily entrenched within insurance contracts and cannot be waived by agreement.[148] Theoretically funding agreements could whittle away the implied

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duty of good faith the contracting parties must refrain from arbitrary or unreasonable conduct. This is considerably weaker than requiring them to act solely in the principal's interests: *Garry Rogers Motors (Aust) Pty Ltd v Subaru (Aust) Pty Ltd* [1999] ATPR 41-703 at [37]; *Burger King Corporation v Hungry Jacks Pty Ltd* [2001] NSWCA 187 at [185]; *Shelanu Inc. v Print Three Franchising Corp* (2003) 64 O.R. (3d) 533 at 555-556 (Ont. C.A.).

143 [2005] NSWCA 240 at [70].

144 This duty arises at common law and under statute, see: s13 *Insurance Contracts Act 1984* (Cth).

145 Appendix Question 10 Funder C

146 Appendix Question 10 Funder F.

147 Appendix Question 10 Funders A, B, D & E.

148 Ss13 & 14 *Insurance Contracts Act 1984* (Cth).

duty of good faith to nothing. But arguably waiver of the implied duty of good faith that allows funders to behave arbitrarily and harm claimholders' interests will be vitiated by s51AC *Trade Practices Act 1974* (Cth) or by s12CC *Australian Securities and Investment Commission Act 2001* (Cth).[149] Consequently, sophisticated claimholders who voluntarily consent to delegation of complete control of the proceedings to the funder appear to be adequately protected and the Law Council's concerns unsubstantiated.

Reference should also be made to Part 7 of the *Corporations Act 2001* (Cth), which deals with financial services regulation (hereafter FSR). The provision of litigation funding is likely to be defined as a derivative[150] and therefore fall within the definition of a financial product, subject to FSR regulation. Dealing in a financial product requires a financial services license.[151] In turn, bodies holding financial services licenses under Part 7, including litigation funders, are required to ensure that they have adequate arrangements in place for managing conflicts of interest arising in the course of their financial service businesses.[152] The general nature of this obligation is set out in the ASIC policy statement: 'Licensing: Managing Conflicts of Interest.'[153] According to the Policy Statement the conflicts management obligation requires more than disclosure. It requires the licensee to implement a system for managing conflicts of interest.[154] Moreover, the obligation applies to all clients whether or not they are classified as retail clients.[155] To be adequate, the conflicts management arrangements must correctly identify conflicts of interests and control the effect of the conflicts on the provision of the financial service.[156] In addition, licensees are obliged to monitor the success of their conflict of interest arrangements.[157]

Insofar as retail clients are concerned, litigation funders must have a proper dispute resolution system in place that complies with standards approved by ASIC

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149 See in particular ss51AC (3) (b) (i) & (k) *Trade Practices Act 1974* (Cth) and ss12CC (2)(b), (i) & (k) *Australian Securities Investment Commission Act 2001* (Cth). The discussion of these provisions on funding arrangements is analysed in more depth in Chapter 6.

150 S761D *Corporations Act 2001* (Cth).

151 S911A *Corporations Act 2001* (Cth)

152 S912A(1)(aa) *Corporations Act 2001* (Cth).

153 ASIC *Policy Statement 181* Effective Jan 1 2005.

154 Ibid at [PS 181.21].

155 Ibid at [PS 181-22]. Retail clients are essentially individual or small business clients, see: s761G *Corporations Act 2001* (Cth).

156 Ibid at [PS181 – 30].

157 Ibid.

comprising both an internal dispute resolution system and membership of an external dispute resolution scheme.[158]

Multiple Claim Holders

There are no specific model rules governing the ethical duties of lawyers in representative actions, nor are litigation funders subject to special class action regulation. Consequently, the Courts will be required to undertake the oversight of conflicts of interests in representative proceedings between funder, legal practitioner and claim holder on a case-by-case basis.

Many of the potential conflicts that arise between single clients, funders and legal practitioners are also potential conflicts in representative proceedings. Therefore the article will not re-canvass them at this point, except to highlight some of the factors that make them more intractable.

Representative proceedings are commenced in the name of a lead party or parties. In Victoria and the Federal Court, the minimum number of persons whom the lead plaintiff(s) represents is seven.[159] The role of the named plaintiff is analogous to that of the single claimant in traditional adversarial litigation. The lead plaintiff must satisfy jurisdictional and standing requirements that a single plaintiff would be required to satisfy, as well as additional threshold requirements for initiating representative proceedings, such as a degree of connectedness between class members' claims.[160] Hypothetically, the representative plaintiff exercises 'near total dominion' over the conduct of the proceedings with little or no input from other class members.[161] The lack of control over proceedings exercised by group members is, however, off-set by their immunity from costs.[162] Furthermore, the interests of group members are also heavily safeguarded by judicial supervision of the proceedings and

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158 Ss912A(1)(g) & (2) *Corporations Act 2001* (Cth).

159 S33C(1)(a) *Federal Court of Australia Act 1976* (Cth); s33C(1)(a) *Supreme Court Act 1986* (Vic). No limits apply in New South Wales: Rule 7.4 *Uniform Rules of Civil Procedure*; Queensland: R75 *Uniform Rules of Civil Procedure*; South Australia: R34.01 *Supreme Court Rules*; Western Australia: O 18 r 12 *Rules of the Supreme Court*.

160 Ss33C(1)(b) & (c) *Federal Court of Australia Act 1976* (Cth); ss33C(1)(b) & (c) *Supreme Court Act 1986* (Vic). In states which do not apply the Federal Court model, similar principles apply: *Carnie v Esanda Corporation* (1995) 182 CLR 398.

161 Grave D & Adams K *Class Actions in Australia* [Pyrmont, NSW: Lawbook Co Ltd, 2005] at p132. However the 'near total dominion' referred to by the authors is actually exercised by the legal practitioners supervised by the Court.

162 S43(1A) *Federal Court of Australia Act 1976* (Cth); s33ZD *Supreme Court Act 1986* (Vic). However note that group members can be liable for costs under certain circumstances in ss33Q & R *Federal Court of Australia Act 1976* (Cth) and ss33Q & R *Supreme Court Act 1986* (Vic).

the communications between legal practitioners and group members, and by court approval of settlement. If group members do not wish to be bound by any judgment or settlement between the lead plaintiff and respondents, they may choose to 'opt out'. Alternately, they will not be bound in other jurisdictions which adopt an 'opt in' model unless they consent.

Factors that tend to complicate conflicts of interest arising between the funder, claimholders and legal practitioners in representative proceedings include:

- Potential collusion between the legal practitioner, defendant and funder
- Free rider problems associated with the sharing of litigation risk & the recovery of the funder's success fee
- Conflicts between members of representative proceedings

Potential collusion between the legal practitioner, defendant and funder

One of the major complaints levelled against American style class actions is the temptation they provide for plaintiffs' lawyers and defendants to collude.[163] Both lawyers and defendants have an incentive to settle cheaply. Defendants obviously want to minimize their losses and foreclose any further expensive litigation. In the case of lawyers with a portfolio of claims, quick settlement with a minimum of effort ensures cash flow. Trials, on the other hand, are expensive and the outcomes, while predictable, are far from guaranteed. Proceeding to trial also incurs substantial opportunity cost. By settling early the lawyer avoids these costs and can recover substantial fees independent of the damages recovered by claimholders, most of whom are not in a position to voice their concerns regarding the adequacy of their compensation.

Arguably the interposition of a funder in the lawyer-client relationship is likely to reduce rather than exacerbate potential lawyer-defendant collusion. The funder's primary motivation is claim maximization. Rather than supporting minimum effort from the lawyers involved, the funder wants to extract as much efficiency from the

[163] Coffee JC 'Understanding the Plaintiff's Attorney: the Implications of Economic Theory for Private Enforcement of Law Through Class and Derivative Actions (1986) 86 *Columbia Law Review* 669, 714; Hensler D, Pace NM, Dombey-Moore B, Giddens B, Gross J & Moller E *Class Action Dilemmas: Pursuing Public Goals for Private Gain* supra at pp79 – 85; Coffee JC 'Class Wars: The Dilemma of the Mass Tort Action' (1995) 95 *Columbia Law Review* 1343, 1367 – 84; Issacharoff S 'Class Action Conflicts' (1997) 30 *UC Davis L Rev* 805, 821; Hay BL & Rosenberg D '"Sweeheart" and "Blackmail" Settlements in Class Actions: Reality and Remedy' (2000) 75 *Notre Dame L Rev* 1377, 1389; Koniak SP & Cohen GM 'In Hell there Will be Lawyers without Clients or Law' (2001) 30 *Hofstra L Rev* 129, 156; Bronsteen J 'Class Action Settlements: An Opt In Proposal' (2005) *U Ill L Rev* 903, 910 - 915.

claimholders' lawyers as possible. However, funders also maintain a portfolio of claims and may require cash flow from time to time to balance outflows to their other investments. While unlikely, collusion between funders and lawyers in need of cashflow and defendants seeking quick, cheap and final settlement cannot be discounted. However, judicial monitoring and approval of settlement should prevent and deter such behaviour.[164]

To implement funding agreements on a broad scale, the funder will necessarily have to have a close working relationship with the lead plaintiff's solicitors. Both the funder and the solicitors are under enormous financial pressure to attract and maintain a sufficient number of group members to funding and retainer agreements to ensure the viability of their respective investments.[165] It is in this respect that collusion between the funder and lawyers is likely to be deleterious to claimholders' interests. These problems are discussed in more depth below in relation to means adopted by the funder and lawyers to minimize free-riding on claim prosecution.

Free Rider Problems Associated with the Sharing of Litigation Risk & the Recovery of the Funder's Success Fee

Representative proceedings are inherently more complex and expensive than ordinary adversarial proceedings.[166] Consequently the means by which representative proceedings can be financed has been described as the most important determinant of their viability.[167] Without litigation funding and conditional fee arrangements cost barriers are simply too high for representative plaintiffs and their legal representatives to invest the time and resources required to successfully develop and prosecute a class claim. In addition, as a result of the cost-shifting rule the risk associated with representative proceedings is great. Should a case be lost, the claimholder is not only out of pocket for legal expenses incurred in claim prosecution

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[164] However, Bronsteen 'Class Action Settlements: An Opt In Proposal' supra at pp915 - 916 argues that judicial incentive for preventing collusive settlements is less than ideal. He argues that judges are reluctant to oppose settlement and force the parties to trial because this would increase their own workload. According to Bronsteen judges have an overwhelming incentive to clear their docket. Further because there is no market for legal claims, judges have no measure for determining whether a settlement is fair. Judges are unable to put themselves into claimholders' shoes and validly determine whether a reasonable claimholder would or would not accept a settlement. See further Silver C 'Class Actions- Representative Proceedings' (2000) 5 *Encyclopaedia of Law and Economics* 194, 216.

[165] See further below.

[166] See discussion of Morabito V 'Contingency Fee Agreements With Represented Persons in Class Actions: An Undesirable Australian Phenomenon' (2005) 34 (3) *Common Law World Review* 201, 206 – 211.

[167] Grave D & Adams K *Class Actions in Australia* n159 at p437; Morabito V ibid at 206 – 208.

but also liable for a significant amount of the opposing party's costs unless a litigation funder or law firm has agreed to indemnify the claimholder beforehand.[168]

Where litigation costs and risks are shifted to a funder, naturally the funder will require suitable recompense. However, the source of recompense is limited to those who enter into funding agreements. Without an agreement, the funder has no right to recover its expenses or any success fee.

In the event of a successful judgment or settlement, funding agreements typically provide that the funder is entitled to recover its expenses from the plaintiff drawn down from an award of costs made in the plaintiff's favour and/ or from the award of damages.[169] In addition, the funder is usually entitled to a portion of the representative plaintiff's damages as a success fee. The success fee represents the profit due to the funder for accepting litigation risk. However, because of the large scale of representative proceedings, for the funder's investment to be viable, the funder's expenses and success fee must be recouped from a larger pool of damages than the lead plaintiff's alone. The pool of damages available to recompense the funder must be sufficiently large to off-set the total costs incurred by the funder and the significant risk undertaken.

The need to broaden the pool of damages explains why funders together with legal practitioners acting subject to conditional fee arrangements, invest substantial resources into identifying potential claimholders and marketing their services to them. In one of the tobacco retail levy matters, for example, IMF (Australia) Ltd employed 150 canvassers to go out into the marketplace, meet with retailers and sign them up to funding agreements.[170] Subsequently, 8000 individual retailers entered into litigation funding agreements with IMF to pursue actions against Phillip Morris and British American Tobacco. In the *Fostif* matter, a marketing firm, Horwath GST Pty Ltd, was employed to market the claim to retailers for a return equal to .5 of the funder's 33.3% success fee. Horwath signed up 2100 clients, although there were potentially 10,000 claimholders that might be identified through discovery and who might later join the proceedings following further representations from Horwath and

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168 For this reason lead plaintiffs are often 'men of straw': see Lindgren J in *Cook v Pasminco Ltd (No 2)* 107 FCR 44 at [29 – 30]. The ability to recover adverse costs from a funder ought to give some comfort to respondents/defendants who might not recover otherwise and further buttresses the view that the interposition of a funder will not facilitate abuse of process.

169 It is estimated that party-party costs only contribute about 50 - 66% toward the total costs incurred in legal proceedings: Grave D & Adams K n159 at p447. Accordingly, the funder is likely to be reimbursed from both an award of costs and from damages.

170 Walker J, IMF (Australia) Ltd December 2004 Presentation available at http://www.imf.com.au/pres200412.asp [accessed 27th March 2006].

the funder. In the *Clairs Keeley* matter, IMF, assisted by a claim spotter who agreed to act for 5% of claim revenues, persuaded 2,500 claimholders to enter into funding agreements.[171]

Despite funder success in attracting claimholders to funding agreements, free-riding[172] by other claimholders remains a problem. From the funder's perspective the ability of other claimholders to free-ride on its risk undermines the viability of its investment in the claim. As a result of free-riding insufficient claimholders may be willing to sign funding agreements or they may terminate their funding agreements and reduce the funder's profit.

One means by which the funder can attempt to prevent free-riding is to make entry into the funding agreement a criteria for group membership. This can be done under the 'opt in' model but not under the 'opt out' model of representative proceedings. Compared to the Federal and Victorian legislative frameworks, there are few detailed guidelines for the governance of 'opt in' representative proceedings. In particular there are no rules determining whether the criteria for joining an 'opt in' group can require members to enter into funding or retainer agreements. In *Fostif Pty Ltd v Campbells Cash & Carry Pty Ltd*,[173] however, such criteria were permissible. The Court accepted that the initial group of persons whom the lead plaintiff purported to represent, that is, claimholders seeking restitution of tobacco levies paid to wholesalers, could be narrowed further pursuant to opt in notices requiring accession to the funding agreement. According to the Court, obliging group members to enter a funding agreement did not disadvantage them. Despite finding that Pt 8 r13 *Supreme Court Rules 1970* (NSW) had not been properly invoked because no person was named in the summons as a 'represented retailer', the High Court did not demur to the view of the Court of Appeal on this issue.

Under the 'opt in' model, if a claimholder does not wish to retain the solicitors representing other group members or to enter into the proffered funding agreement it is open to that claimholder to commence his or her own individual proceedings or

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171 *Clairs Keeley (a firm) v Treacy* (2003) 28 WAR 139.

172 Free riders are actors who take more than their fair share of the benefits of a project or situation compared to the proportion of the costs that they bear, see: Albanese R & Van Fleet DD 'Rational Behaviour in Groups: The Free-riding Tendency' (1985) 10 *Academy of Management Review* 244.

173 (2005) 63 NSWLR 203 at [206 – 210]. According to Mason P at 210:
'Undoubtedly, it is also the intent of the lead plaintiffs that participation is dependent upon submission to Firmstone's conditions. There could however be no objection to this in itself, all the more so since the conditions themselves and the management of this opt-in procedure are placed under judicial supervision by the invocation of the Rule. The capacity to negotiate those terms is not excluded.'

to attempt to create a new group of claimholders. Alternatively the claimholder can take no action and his or her rights will remain unaffected. However, once the 'opt in' group is closed the opportunity for free-riding is decreased. Although claimholders who elect not to 'opt in' could theoretically ride on the coat tails of a successful settlement or judgment engineered by the funded representative party, the expiration of time limits[174] and abuse of process[175] concerns make that less likely.

By contrast, under the 'opt out' model, group members are entitled to enjoy the benefits flowing from a successful representative proceeding regardless of whether they contribute financially to the proceedings. As a result, 'opt out' group members have no rational incentive for entering into funding or retainer agreements.[176] Instead they can free-ride on the risk and efforts of the lead plaintiffs, the funder and the lead plaintiff's lawyers.

The incentive to free-ride creates a 'prisoner's dilemma'.[177] If the viability of the funder's investment is undermined by free-riding claimholders, the funder will be forced to withdraw. For this reason, it seems that funders and solicitors who are involved in representative proceedings are able to attract large numbers of claimholders to tripartite funding and retainer agreements.[178]

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[174] This was a concern for the 1st instance judge in the *Fostif* matter. See *Keelhall Pty Ltd t/as "Foodtown Dalmeny" and 6 Ors v IGA Distribution Pty Ltd formerly known as Davids Distribution Pty Ltd & 3 Ors, etc* [2003] NSWSC 816 at [60] where the 1st instance judge found that the decision to initiate group proceedings just prior to the expiration of the limitation period effectively gave the funder a monopoly over the means to access recovery and denied other potential group members the opportunity to bargain in respect of legal fees or funding fees. On appeal, the New South Wales Court of Appeal did not regard this as a matter relevant to establishing abuse of process: *Fostif Pty Ltd v Campbell's Cash & Carry Pty Ltd* (2005) 63 NSWLR 203 at [125].

[175] To avoid multiple proceedings courts may either order consolidation or else stay proceedings, which re-litigate similar issues on abuse of process grounds. However note that in *Taylor v Nugent Care Society* [2004] EWCA Civ 51, a litigant who was refused entry to an opt in group claiming damages for assault while resident at the defendant's institution, was permitted to commence individual proceedings in parallel to the group proceedings. The defendant's argument that the second individual proceedings constituted an abuse of process failed. See further *Johnson Tiles Pty Ltd v Esso Australia Ltd* (1999) ATPR 41-679 regarding the multiplicity of proceedings under the opt out model of representative proceedings

[176] Morabito V n161 at p215.

[177] In game theory, a prisoner's dilemma is a non-zero sum game where both players have an incentive not to co-operate with each other. However if they did co-operate collectively they would be better off. The prisoner's dilemma reflects tension between self-interest and collective interest. See further Rapoport A & Chammah AM *Prisoner's Dilemma: A Study in Conflict and Co-operation* [Ann Arbor: Uni of Michigan Press, 1965].

[178] See discussion infra.

If the funder is unable to attract a large number voluntarily it is unlikely that entry into a funding agreement or retainer will be permitted as valid criteria for group membership in 'opt out' proceedings. In *Dorajay Pty Ltd v Aristocrat Leisure Ltd*[179] and *Rod Investments (Vic) Pty Ltd v Adam Clark*[180] group membership criteria confined to the clients of a particular firm of solicitors was held to be contrary to the legislative opt out policy exemplified in the Federal and Victorian framework. For similar reasons, narrowing the definition of the class of persons entitled to participate in settlement benefits to those who enter retainer and funding agreements is also unlikely to be approved as a fair and reasonable under s33V. In *Williams v FAI Home Security Pty Ltd (No 4)*[181] Goldberg J found that limiting the definition of the group entitled to participate in settlement to group members with retainer agreements created a conflict of interest between those party to the retainer and those not party but still bound by the settlement. To facilitate resolution of the conflict, at a minimum, the unrepresented group members had to be notified of the proposed settlement and given an opportunity to have their views put before the court.[182]

Nor will the funder be able to protect its position pursuant to s33ZJ *Federal Court of Australia 1976* (Cth)/ *Supreme Court Act 1986* (Vic) which creates a 'common fund' to enable the lead plaintiff to recover the difference between its party-party costs recoverable from a respondent and its own solicitor-client costs from the pool of damages awarded to group members. According to the High Court in *Cachia v Hanes*:[183]

> Costs, within the meaning of the Rules, are reimbursement for work done or expenses incurred by a practitioner or a practitioner's employee…..costs are awarded by way of indemnity….for professional legal costs actually incurred in the conduct of litigation.

This definition precludes funders' fees and also seems to preclude legal practitioners' success fees. More importantly it is limited to the recovery of costs incurred individually by the lead plaintiffs. This would not meet the demand from funders for a portion of damages awarded to a large number of group members.

It may be possible for the Court to apportion funder or legal practitioner success fees among group members pursuant to s33V(2), which permits orders 'as are just with respect to the distribution of any money paid under a settlement or paid into Court'.

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179 (2005) 147 FCR 394.
180 [2005] VSC 449.
181 (2001) 180 ALR 459 at [22].
182 Ibid at [23].
183 (1994) 179 CLR 403, 410

In *Johnson Tiles Pty Ltd v Esso Australia Ltd*[184] Merkel J stated that s33V(2) extended to the payment of legal costs out of group members' damages.[185] However, it is unlikely that the Court will use its power under s33V(2) to order group members to pro rata share the burden of litigation funding in the absence of voluntary funding agreements.[186] Moreover, dependence on judicial discretion after funding is provided is unlikely to assuage funder concerns regarding their risk.

Thus, as noted earlier, whether or not an 'opt in' or 'opt out' model is adopted, funders are under considerable pressure to 'sign up' as many group members as possible to funding agreements. Of necessity these must be linked to retainer agreements with a particular firm of solicitors – since it is the solicitors representing the lead plaintiffs that have charge of the proceedings. In turn, the solicitors cannot instigate class proceedings without assurance that the funder will underwrite their fees. The need to heavily market funding and retainer agreements as linked

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184 (1999) 94 FCR 167 at [16].

185 See further *Williams v FAI Home Security Pty Ltd (No 4)* (2000) 180 ALR 459; *King v AG Australia Holdings (formerly GIO Australia Holdings Ltd)* (2002) 191 ALR 697; *Courtney v Medtel Pty Ltd* (2002) 122 FCR 168.

186 Arguably the rationale of the Court's power under s33V(2) is limited by notions of unjust enrichment which arise as a result of free riding by group members on the efforts of the lead plaintiffs and their solicitors: see Australian Law Reform Commission Report No. 46 *Grouped Proceedings in the Federal Court* [Canberra: AGPS, 1988] Ch 8, [289 – 290]. At [290] the ALRC deliberately limited its discussion of amounts recoverable from group members' damages to the recovery of solicitor-client costs. This suggests that moneys recoverable ought to be limited to the cost of services actually performed albeit on a pro rata basis and that it excludes uplift fees and funder success fees. The case for recovering funder success fees on the basis of unjust enrichment is very weak unless the claimholders concerned have represented that they will enter funding agreements and the funder has expended funds relying upon their individual representations.

Subsequently the ALRC has modified its views. In the *Managing Justice* Report No. 89 [Canberra: AGPS, 2000] at para 7.126 the ALRC recommended that Part IV A *Federal Court of Australia Act 1976* (Cth) be amended to enable the Court to approve conditional fee agreements with lead plaintiffs and group members. In any event, the Courts appear to be doing so without specific legislative powers. In *Courtney v Medtel Pty Ltd No.5* (2004) 212 ALR 311, a settlement scheme was approved whereby group members contributed toward 20% of the costs that were allocated to the class solicitors. These costs included an uplift fee of 25%. However conditional fee agreements were firmly in place with each group member and the Court indicated that it would only approve the settlement if evidence was adduced from an independent costs consultant as to the reasonableness of the fees including the uplift fee.

See further *King v AG Australia Holdings (formerly GIO)* [2003] FCA 980 where Moore J approved a settlement comprised of payment of $97 million into a claims resolution facility plus $15million to the class lawyers for professional costs and disbursements inclusive of a 25% uplift fee. A small proportion of the group members - 5% - did not enter retainer agreements with the class lawyers.

agreements has the capacity to undercut the legal practitioner's fiduciary duty to claimholders. It can also create conflicts of interests between funded and non-funded class members.

Whether or not they enter retainer and funding agreements, class lawyers owe fiduciary duties to all members of the represented group.[187] That fiduciary duty requires the solicitors to make proper disclosure of all financial arrangements that apply to the conduct of the proceedings including the risks and costs associated with linked funding agreements. Yet leaving disclosure to class lawyers who remain conflicted as a result of their financial dependence upon the funder is fraught with difficulty. As a result of the pressure to attract large numbers of claimholders to funding and retainer agreements, there is a significant temptation to downplay their risks and costs. There are already a number of examples of misleading 'opt in' or 'opt out' notices concerning contingency arrangements arising in case law.[188]

In representative proceedings disclosure to the representative group generally occurs when 'opt in' or 'opt out' notices are sent to identified claimholders and circulated in the press. Notice to all claimholders is also required if settlement is proposed.[189] The Court approves the form, content and method by which the notice is given.[190] Judicial approval of class communication ought, therefore, impede misleading marketing of linked retainer and funding agreements, and alert legal practitioners and funders of the need for complete transparency. As alluded to above, the Federal Court and the Victorian Supreme Court have begun developing jurisprudence as to the requisite content of such notices when it comes to explaining conditional fee agreements especially in relation to the potential liability of group members for legal costs.[191]

The courts have yet to develop guidelines as to the content of notices regarding linked funding agreements. However this may not be necessary if the Financial Services provisions and/or the Managed Investment Scheme provisions of the *Corporations Act 2001* (Cth) apply to litigation funding of class actions. While there is not a strong case for applying these provisions between sophisticated commercial operators, class action claimholders, on the other hand, are likely to fall within the

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187 *McMullin v ICI Australia Operations Pty Ltd* [1997] 1426 FCA; *King v AG Australia Holdings (formerly GIO Australia Holdings Ltd)* ibid at [24] & [27]; *Courtney v Medtel Pty Ltd* (2002) 122 FCR 168 at [57].

188 Eg *Johnstone v HIH Limited* [2004] FCA 190; *Petrusevski v Bulldogs Rugby League Club Ltd* [2003] FCA 1056; *King v GIO Australia Holdings Ltd* [2001] FCA 270 at [14]; *Johnson Tiles Pty Ltd v Esso Australia* (1999) 166 ALR 731.

189 Section 33X (4) *Federal Court of Australia Act 1976* (Cth)/*Supreme Court Act 1986* (Vic).

190 Section 33Y *Federal Court of Australia Act 1976* (Cth)/ *Supreme Court Act 1986* (Vic).

191 The guidelines in relation to costs and conditional fee agreements developed in these cases are discussed at length in Grave D & Adams K n159 at 8.250 – 8.330.

definition of 'retail clients' set out in the Financial Services provisions[192] and therefore fall within the very category of persons the provisions were designed to protect. Under the Financial Service provisions, litigation funders are required to serve claimholders with extensive financial services guides and product disclosure statements.[193] Financial Services Guides must provide details about the litigation funder and the kinds of services it offers; information about whom the funder acts for when providing the financial service;[194] and information about the funder's remuneration and that of its associates.[195] Product disclosure statements must set out the costs, benefits and risks of litigation funding, commissions (eg spotter's fees), significant features of litigation funding, taxation implications and dispute resolution procedures applicable for complaints about litigation funding arrangements.[196] If litigation funding of class actions is a managed investment scheme, the scheme must be lodged with the Australian Securities and Investment Commission together with a scheme constitution and compliance plan compliant with the relevant provisions of the *Corporations Act 2001* (Cth).[197]

Combined, judicial oversight of class communication and the Financial Services Regulations, should be sufficient to address the temptation to provide less than the proper amount of information when trying to persuade claimholders to sign up to agreements. Whether this information is sufficient to adequately explain the conflicts of interests that might arise between legal practitioners and funders, on the one hand, and claimholders on the other is open to question. Non-repeat small claimholders are unlikely to appreciate the incentives for legal practitioners, funders and respondents to collude at their expense merely because a linked retainer and financial agreement are disclosed to them. Nor does the provision of information necessarily overcome the lack of incentive group members have for pursuing their individual interests in the face of a perceived conflict.

Obviously judicial oversight of settlement, particularly of terms related to costs, uplift fees and funder success fees remains pivotal. Section 33V (1) provides that

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192 Section 761G *Corporations Act 2001* (Cth).

193 Ss941A & 1012B *Corporations Act 2001* (Cth).

194 To avoid the imposition of fiduciary duties, the Financial Services Guide should disclaim that the funder is acting on behalf of the claimholder and should clearly state that the funder is acting solely in its own best interests.

195 Section 942B *Corporations Act 2001* (Cth). NB Class lawyers do not appear to fall within the definition of an associate for the purposes of s942B, see: s13 *Corporations Act 2001 (*Cth) even though the funding and retainer agreements are necessarily linked agreements.

196 Section 1031D *Corporations Act 2001* (Cth).

197 Section 601EA *Corporations Act 2001* (Cth).

representative proceedings cannot be settled without approval of the Court.[198] The Court must be satisfied as to the fairness and reasonableness of the settlement taking account of the following factors:[199]

- The amount offered to each group member and the basis for differentiating between group members
- The prospects of the proceeding leading to a successful judgment in favour of the representative plaintiff
- The likelihood that group members might obtain a judgment significantly greater than the settlement amounts offered to them
- The likely duration and cost of continuing to judgment
- The attitude of group members
- The ability of the respondent to satisfy a larger settlement or judgment

Generally speaking the Court prefers settlements where the proportion of funds to be allocated for legal costs (including uplift fees) is clearly identified.[200] Before approving the sum set aside for the payment of costs, the Court will require evidence from an independent costs expert regarding the reasonableness of the terms of the fee and retainer arrangements including the reasonableness of the uplift fee, whether the fees and disbursements have been charged in accordance with the retainer, and evidence that no costs have been incurred unnecessarily or oppressively.[201] By analogy the amount of remuneration due to funders should be clearly identified and independent expert evidence should be adduced in relation to the reasonableness of funder success fees.

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198 This does not prevent individual group members from settling their claims outside of the global settlement negotiated by the class lawyer and lead plaintiff. Further, group members who are not retained by the class lawyer are not in a solicitor-client relationship and therefore there is nothing to stop the respondent/defendant from soliciting individual settlements from them and undermining the viability of the class claim: *King v AG Australia Holdings Ltd* (2002) 121 FCR 480. Professional conduct rules prohibit respondents from communicating with group members who are in retainer agreements: Law Council of Australia, *Model Rules of Professional Conduct and Practice* R18.4.

199 *Williams v FAI Home Security Pty Ltd (No. 4)* (2000) 180 ALR 459 at [19]; *Lopez v Star World Enterprises Pty Ltd* (1999) ATPR 41-678 at 42, 670; *McMullin v ICI Australia Operations Pty Ltd* [1997] 1426 FCA at 3.

200 See *Reiffel v ACN 075 839 226 Pty Ltd (No 2)* [2004] FCA 1128 at [11] where Gyles J expressed some unease about a global settlement inclusive of costs but nonetheless approved such a scheme.

201 *Courtney v Medtel Pty Ltd (No. 5)* (2004) 212 ALR 311 at [59].

Dealing with conflict of interest between class members

Conflicts of interest arising between class members are likely to be more acute under the 'opt out' model of representative actions.[202] Under the 'opt in' model the class can be limited to those who enter funding agreements. However, as outlined, no such limits can apply in the 'opt out' model. Under the opt out model, the greater the compensation awarded to funded members of the group proceedings, the greater reward that funders will receive as a percentage of the total claims pool. Accordingly, there is a significant temptation for funders acting in conjunction with solicitors not to advocate as hard for non-funded group members, or worse, to negotiate settlements with respondents/defendants that increase the proportion of compensation awarded to funded claimholders but decrease the global pool of compensation at the expense of non-funded claimholders. Similar potential conflicts have already been identified between claimholders with retainer agreements inclusive of an uplift fee and claimholders without such retainer agreements.[203]

The Court is empowered to address such conflicts by the following means:

- Substitution of another person where the existing representative is inadequate to represent the interests of sub-group of the group ie effectively creation of a new sub-group[204]
- Discontinue the proceeding as a group proceeding[205]
- Exercising its powers to set aside settlement[206]

Bronsteen is of the view that reliance upon the judiciary to effectively control conflicts of interest under these powers is over sanguine.[207] According to Bronsteen, judges have significant personal and institutional incentives to permit settlements to clear their decks of workload and improve court efficiency. Bronsteen also argues

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202 For discussions regarding conflicts of interest between group members generally see: Note 'Conflicts in Class Actions and Protection of Absent Class Members' (1982) 91 *Yale L J* 590; Hensler D, Pace NM, Dombey-Moore B, Giddens B, Gross J & Moller E n1021 at pp114 – 118; Miller G 'Conflicts of Interest in Class Action Litigation: An Inquiry into the Appropriate Standard' (2003) *Uni of Chicago Legal Forum* 581; Koniak SP 'How Like a Winter? The Plight of Absent Class Members Denied Adequate Representation' (2004) 79 *Notre Dame Law Review* 1787.

203 Eg *Williams v FAI Home Security Pty Ltd (No 4)* (2000) 180 ALR 459; *Courtney v Medtel Pty Ltd* (2002) 122 FCR 168 at [57]; *Petruveski v Bulldogs Rugby League Club Ltd* [2003] FCA 1056.

204 S33T *Federal Court of Australia Act 1976* (Cth)/*Supreme Court Act 1986* (Vic).

205 S33N *Federal Court of Australia Act 1976* (Cth)/*Supreme Court Act 1986* (Vic)

206 S33V *Federal Court of Australia Act 1976* (Cth)/ *Supreme Court Act 1986* (Vic).

207 Bronsteen J 'Class Action Settlements: An Opt-in Proposal' (2005) *Uni of Illinois L Rev* 903, 915 – 916.

that judges are ill-equipped to evaluate the reasonableness and fairness of settlements because of the lack of a market in legal claims. Bronsteen contends that without such a market there is no yardstick to measure whether a claimholder, especially an absent claimholder, would have accepted any particular settlement offer. It is also pertinent that judges are heavily reliant upon the opinions of Senior Counsel and costs consultants, whose independence cannot be completely guaranteed in the small world of commercial litigation where repeat work is economically essential.

However, while acknowledging these shortcomings, it is difficult to agree with Bronsteen that Australian judges would permit unfair discrimination between funded and non-funded claimholders. Such discrimination would be obvious and unlikely to pass by the attention of even an overworked and underpaid judge sensitive to appellate review and to criticism from the community. Case law concerning discrimination based on conditional fee agreements demonstrates that judges are aware of the commercial conflicts that can arise in entrepreneurial litigation and that they are willing to address them vigorously.[208]

Morabito and the Australian Law Reform Commission[209] contend, however, that conditional fee agreements (and by implication) funding agreements ought to be subject to independent judicial approval in addition to the judicial approval of class communication and judicial approval of class settlement to ensure:

1. More complete oversight of conflicts between group members; and
2. Better protection of vulnerable group members subject to sales tactics employed by entrepreneurial solicitors (and funders).[210]

Whether specific legislative amendments are required to achieve the first goal is debatable. Funding agreements are already subject to considerable judicial oversight insofar as they have the capacity to facilitate conflicts between class members.[211]

Judicial oversight of funding agreements is less contentious provided it occurs for limited purposes. Neither Morabito nor the Australian Law Reform Commission outline the basis upon which judicial approval should be made. Rather they appear to be advocating that the Court develop principles for review on a case-by-case basis.

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[208] Eg *Johnson Tiles Pty Ltd v Esso Australia Ltd* (1999) 166 ALR 731; *Williams v FAI Home Security Pty Ltd (No 4)* (2000) 180 ALR 459; *Courtney v Medtel Pty Ltd* (2002) 122 FCR 168 at [57]; *Petruveski v Bulldogs Rugby League Club Ltd* [2003] FCA 1056.

[209] Australian Law Reform Commission *Managing Justice* Report No. 89 [Canberra: AGPS, 200] at paras 7.126 –7.128.

[210] Morabito V n1184.

[211] See comments of Mason P in *Fostif Pty Ltd v Campbells Cash & Carry Pty Ltd* (2005) 63 NSWLR 203 at [210].

Presumably, however, the Court would consider matters such as unconscionability, misleading and deceptive conduct and the implied duty of good faith, and, in so doing, act as the guardian for easily manipulated group members whose interests might not be adequately protected because of the strong interdependence between the lead plaintiff's lawyers and the funder. It would be unrealistic to expect group members whose incentive for initiating proceedings in the first place is low, to have sufficient incentive to scrutinize and then pursue claims against funders based on allied funding agreements. Without proper legal advice and representation there is doubt that group members would even be aware of such problems.

However, adding another layer of judicial approval may be unnecessarily paternalistic if the Court saw its role as an arbiter of the general fairness and reasonableness of the funding agreement and attempted to re-bargain the agreement on behalf of group members. At this stage, there is little evidence of claimholder dissatisfaction with funding agreements. Although funders might be self-serving in this regard, they generally report claimholder gratitude for the assistance provided in facilitating access to justice and in facilitating the efficient prosecution of proceedings.[212] The fact that funders are succeeding in attracting huge numbers of claimholders to proceedings and that no substantial complaints have emanated from the claimholders themselves (although the Courts have had to deal with many motions from disgruntled respondents/defendants) bolsters the view that judicial oversight should be confined to matters that might vitiate the agreements rather than to more esoteric notions of fairness and reasonableness. Thus provided judicial restraint applies, the registration and approval of funding agreements would ensure transparency in the treatment of all group members and would also assist the Court later in its determination of the fairness and reasonableness of global settlement.

Duties to the Court and to Justice

One of the problems that the courts have with funders exerting control over the conduct of proceedings is the potential for that control to compromise legal practitioners' duties to the court. Under the Model Rules[213] and at common law,[214] legal practitioners must not mislead the court or knowingly engage in or assist an abuse of process.

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[212] Appendix Question 11- reporting no or little problems associated with conflicts of interest. See further Public Interest Advocacy Centre Submission to the State and Commonwealth Attorneys-General Committee on the Regulation of Litigation Funding, October 4 2005. Unpublished. Copy on file with author.

[213] Law Council of Australia, *Model Rules of Professional Conduct and Practice*, Rules 12 – 19.

[214] *Giannarelli v Wraith* (1988) 165 CLR 543 at p555 - 556 per Mason CJ; *Orchard v South Eastern Electricity Board* [1987] QB 565; *Abse v Smith* [1986] QB 536.

Litigation funders do not owe duties to the court. Therefore they are under no obligation to inform the court of information that might be inconsistent with the claim holder's pleaded case, to inform the court concerning adverse expert opinion, or to release harmful documentary evidence that the claim holder, for nefarious reasons, may have withheld. Litigation funders invariably take the view that duties to the court are a matter for the claim holders' lawyers.[215] Indeed one funder suggested that unless and until insurers were also under a duty to the court to disclose information concerning abuse of process or other impropriety, it would be irrational to impose such a duty upon funders.[216]

The New South Wales Court of Appeal supports the views of the litigation funders. In *Project 28 Pty Ltd v Barr,*[217] the New South Wales Court of Appeal determined that funder control of proceedings did not necessarily facilitate any breach of legal practitioners' duties to the court or to the system of justice. According to Ipp JA, who delivered the leading judgment, legal practitioners, whether appointed by a non-funded client, a funded client or by a funder are required to conduct proceedings with propriety. There was nothing particular about the interposition of a funder, which suggested to Ipp JA, that solicitors or counsel would not adhere to this obligation any more than they might if pressured by an over-zealous non-funded client. Ipp JA felt that improper pressure from a funder was unlikely. If a funder attempted to instruct legal counsel or solicitors in a manner that was inconsistent with ethical obligations or court orders, the funder would expose itself to liability for contempt of court.[218]

Additionally, litigation funders are also potentially exposed to tortious liability for abuse of process.[219] Given the high level of managerial influence that funders exercise over the conduct of proceedings there is ample basis for liability as a joint tortfeasor

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[215] See Appendix Question 16.

[216] See Appendix Question 16 Funder C.

[217] [2005] NSWCA 240 at [82] – [89].

[218] Ibid at [94] – [95].

[219] *Williams v Spautz* (1992) 66 ALJR 585, 589-592 per Mason CJ, Dawson, Toohey and McHugh JJ; *Varawa v Howard Smith Co Ltd* (1911) 13 CLR 35; *Dowling v Colonial Mutual Life Assurance Society Ltd* (1915) 20 CLR 509; *Guildford Industries Ltd v Hankinson Services Ltd* (1973) 40 DLR (3d) 398; *Grainger v Hill* (1838) 4 Bing (NC) 212; 132 ER 769; *Gilding v Eyre* (1861) 10 CB (NS) 592; 142 ER 584. The tort of abuse of process is established where it is shown that a party has instituted litigation for a purpose outside the scope of the proceedings or to obtain some advantage beyond which the law offers. The initiation of unmeritorious litigation may also found a breach of the *Trade Practices Act 1974* (Cth) if it can be proven that the purpose of the litigation is to delay a potential competitor from commencing business or to raise costs for a competitor: *Cadbury Schweppes Pty Ltd v Kenman Developments Ltd* [1991] ATPR 41-116; *Sterling Winthrop v Boots Company* [1995] ATPR 41-433.

should it be demonstrated that proceedings were initiated for an improper collateral purpose, for example, to put pressure on a defendant to settle nuisance proceedings quickly and cheaply.[220] For this reason, when they were asked about this issue, a number of funders indicated that they would consider withdrawing their funding from proceedings should fabrication or impropriety emerge.[221] One funder indicated that in this situation it would seek advice from Senior Counsel, and try to persuade the client to withdraw if possible. If the matter could not be resolved, thereafter the funder would consider withdrawing its financial support.[222]

Conclusion

Funders generally demonstrate sensitivity towards the legal practitioner-client relationship, and in fact, can add value to that relationship on behalf of claimholders who are unable to extract efficiencies because of information asymmetry or lack of bargaining power. In combination, the existing statutory and fiduciary rules of professional conduct together with an implied duty of good faith on the part of funders appear sufficient to regulate conflicts of interest that arise in the tripartite agreement between claimholders, funders and legal practitioner, even where the funder is delegated total control of claim prosecution.

However, there are issues regarding the funding of representative proceedings that warrant concern. Most of these arise because of the shared need of the funder and the retained solicitors to attract and retain as many claimholders as possible to funding and retainer agreements, and their shared need to protect their investment and to maximize their returns.

There is evidence that without vigorous judicial monitoring entrepreneurial funders and solicitors may act unfairly toward unfounded group members in opt out type proceedings. It is therefore recommended that funding agreements in class actions be subject to judicial approval but only on limited grounds that might justify their vitiation for matters such as unconscionability or misleading and deceptive conduct. Otherwise conflicts of interest between funded and non-funded group members appear to be adequately protected through judicial approval of settlement.

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220 *White Industries (Qld) Pty Ltd v Flower & Hart* [1998] 806 FCA; 156 ALR 169; 29 ACSR 21; confirmed on appeal [1999] FCA 773.

221 See Appendix Question 16.

222 Appendix Question 16 Funder F.