YELDHAM PRICE O'BRIEN LUSK

# LITIGATION FUNDING

## High Court to scrutinise litigation funding again

On 28 October 2011, the High Court granted special leave to appeal in the matter of *International Litigation Partners Pte Limited v Chameleon Mining NL (Receivers and Managers Appointed) & Ors*[1]. In doing so, the High Court will be directly examining the role of litigation funders in the Australian justice system for the third time in recent years.

The issue in this case is whether a litigation funding agreement constitutes a 'financial product' within the meaning of Chapter 7 of the *Corporations Act* 2001 (Cth), such that the funder is required to hold an Australian financial services licence (**AFSL**) unless exempted.

At the same time as the *Chameleon Mining* case has been progressing through the courts, regulatory reform in relation to litigation funding has been underway. On 27 July 2011, the Federal Government released an exposure draft of regulations which provide for litigation funding arrangements and those providing them to be exempted from various provisions of the *Corporations Act*, including Chapter 7, subject to having adequate arrangements for managing conflicts of interest.

## Litigation funding in Australia: some background

The funding of litigation, as a commercial exercise, is a relatively new development in the Australian legal landscape, becoming more prevalent within the last ten years or so.

Australian-based and offshore funders are increasingly active in Australia. More recently, new players entering the market are beginning to advertise themselves prominently to lawyers and insolvency practitioners.

Funding tends to be targeted at the types of claim which are likely to maximise the return for the funder, ie high-profile and high-value claims. Class actions are an obvious example, and litigation funders have traditionally been thought of in Australia as being associated with class actions, but their involvement in litigated matters in Australia is broader than that.

Litigation funders see their role as facilitating access to justice. Australia's largest litigation funder, IMF (Australia) Limited, compares its role on the side of plaintiffs to that of insurers on the side of defendants[2].

The High Court has endorsed the funding of litigation on two occasions already. The first was *Campbells Cash and Carry Pty Ltd v Fostif Pty Limited*[3], in which the Court declined to formulate a general rule of public policy that would prevent the practice of funding a party to institute or prosecute litigation in return for a share of the proceeds of the litigation. The second was in *Jeffery & Katauskas Pty Limited v SST Consulting Pty Limited, Jeffery & Katauskas Pty Limited v Rickard Constructions Pty Limited*[4], in which the Court held that a non-party who funded the plaintiff, without indemnifying it for adverse costs orders, had not been shown to have committed an abuse of process.

That is not to say that the practice has been universally welcomed by the judiciary. Notwithstanding the majority approach of the High Court, concerns about the role of litigation funders have been raised by senior judges, in dissenting judgments as well as in views expressed outside the courts.

---

[1] [2011] HCATrans 296

[2] See, for example, *'Litigation Funding and Insurance'* (http://www.imf.com.au/pdf/Paper%20-%20Dluzniak.pdf)

[3] [2006] HCA 41; (2006) 229 ALR 58; (2006) 80 ALJR 1441

[4] [2009] HCA 43

In *Fostif*, dissenting on the issue of whether the proceedings should have been stayed as being contrary to public policy or as an abuse of process, Callinan and Heydon JJ said[5]:

> 'The purpose of court proceedings is not to provide a means for third parties to make money by creating, multiplying and stirring up disputes in which those third parties are not involved and which would not otherwise have flared into active controversy but for the efforts of the third parties, by instituting proceedings purportedly to resolve those disputes, by assuming near total control of their conduct, and by manipulating the procedures and orders of the court with the motive, not of resolving the disputes justly, but of making very large profits. Courts are designed to resolve a controversy between two parties who are before the court, dealing directly with each other and with the court: the resolution of a controversy between a party and a non-party is alien to this role. Further, public confidence in, and public perceptions of, the integrity of the legal system are damaged by litigation in which causes of action are treated merely as items to be dealt with commercially.'

Heydon J continued in this vein in his minority judgment in *Jeffery & Katauskas*, in which his Honour said[6]:

> 'If the court system is 'primarily there' to enable rights to be vindicated rather than to enable commercial profits to be made, it follows that a non-plaintiff who funds the plaintiff with the primary purpose of making commercial profits out of the litigation is behaving extraneously to the proper function of litigation, at least where the funder avoids responsibility for the costs of the defendant. It is behaviour outside the purpose which the process is supplied to serve. It is not making a legitimate use of that process. Rather it abuses that process.'

Only three days before the High Court's decision in *Jeffery & Katauskas*, Keane JA of the Queensland Court of Appeal (as His Honour, now Chief Justice of the Federal Court, then was) made similar points in a paper to the Judicial Conference of Australia, which argued that not only is 'trading in litigation' unattractive in a number of respects but also it may promote the raising of disputes and discourage settlement[7].

From the point of view of parties to funded proceedings, the involvement of a funder can give rise to a number of complications. Control of the litigation can frequently become a contentious issue, with the funder's interests not always being identical with those of the plaintiff.

For defendants, the lack of accountability on the part of funders is a common concern. A funder is not a party to the proceedings which are being funded, and may seek to avoid the consequences of the litigation not succeeding. Certain funders, IMF (Australia) Limited being a prominent example, have sought to address this by espousing transparency, disclosure and voluntarily placing themselves at risk of adverse costs orders (the flip side of this, however, is that they advocate the same for insurers, including disclosure of policies).

In New South Wales, as a result of the High Court's decision in *Jeffery & Katauskas*, calls for funders to be accountable for the adverse consequences of litigation led to the repeal of Rule 42.3 of the *Uniform Civil Procedure Rules* 2005 (NSW), which had been a bar to the making of costs orders against non-parties.

## The *Brookfield Multiplex* case: a precursor to *Chameleon Mining*

In October 2009, the Federal Court delivered its decision in *Brookfield Multiplex Limited v International Litigation Funding Partners Pte Ltd*[8]. Casting doubt over the future of litigation funding arrangements, the Court held that two funded class actions constituted managed investment schemes which, being unregistered, contravened Chapter 5C of the *Corporations Act*.

In response to the decision, in November 2009, ASIC granted transitional relief to lawyers and litigation funders involved in legal proceedings structured as funded class actions that were commenced before 4 November 2009. (Applications in respect of funded actions commenced after that date were considered on a case by case basis.) On 4 May 2010, the Federal Government announced that it would make regulations to exempt funded representative

---

[5] At [266]

[6] At [61]

[7] *'Access to Justice and Other Shibboleths'* (www.jca.asn.au/attachments/2009AccesstoJustice.pdf)

[8] [2009] FCAFC 147

proceedings, that is, funded class actions, and funded proof of debt arrangements from the definition of managed investment scheme, and also from the requirement to hold an AFSL in relation to the provision of financial services associated with such arrangements.

To allow time for that to occur, ASIC granted interim relief in the form of Class Order 10/333, which applied to all funded representative proceedings and funded proof of debt arrangements. The relief under Class Order 10/333 originally had effect until 30 September 2010 but has been extended until 29 February 2012.

## The issues in *Chameleon Mining*

The *Chameleon Mining* case involves an enquiry as to whether a litigation funding arrangement constitutes a financial product within the meaning of the *Corporations Act*. (The court did not consider the issue in *Brookfield Multiplex* because under the Act a managed investment scheme is almost always a financial product.)

The funded proceedings in question were neither representative proceedings nor a proof of debt arrangement, and were not covered by the interim relief under Class Order 10/333. The case illustrates that litigation funders' operations in Australia are not limited to class actions and debt claims.

In *Chameleon Mining*, the dispute is between the funder and the party being funded, and provides an instructive example of the sort of control difficulties which can arise.

The underlying proceedings were commenced in the Federal Court in November 2007 by Chameleon Mining NL (**Chameleon**), a gold exploration company listed on the Australian Stock Exchange, against Murchison Metals Limited (**Murchison**) and others. On 28 October 2008, Chameleon entered into an agreement with a Singapore-based litigation funder, International Litigation Partners Pte Limited (**ILP**), to fund those proceedings. The proceedings went to trial in the Federal Court in September and October 2009 and judgment was reserved[9].

Before judgment was delivered, tensions developed between Chameleon and ILP, relating at least in part to the conduct of settlement discussions with Murchison. ILP sought to invoke the binding opinion provisions of the funding agreement, but Chameleon took the position that it would not agree to be bound by any opinion until a dispute with ILP relating to earlier proceedings was resolved. Other areas of disagreement concerning the conduct of the litigation also arose.

Chameleon then purported to withdraw ILP's authority to instruct or direct lawyers with respect to the proceedings or to negotiate an outcome, which led to ILP asserting that Chameleon was in breach of the funding agreement.

On 10 August 2010, Chameleon signed a terms sheet with Cape Lambert Resources Limited which triggered a change in control of Chameleon, which ILP argued entitled it to payment of its 'funding fee' and also to the 'early termination fee' provided for by the funding agreement.

Chameleon, however, purported to rescind the funding agreement pursuant to section 925A of the *Corporations Act*, which allows the client of an unlicensed financial services provider to rescind the agreement, on the basis that the litigation funding agreement was a financial product and ILP held neither an AFSL nor had the benefit of an exemption from the requirement to hold an AFSL.

On 11 August 2010, ILP appointed receivers to Chameleon, which approached the Supreme Court of NSW for relief. The matter was expedited and heard before Hammerschlag J on 17, 18 and 19 August 2010.

Chameleon contended that no fees were payable to ILP by Chameleon, by reason of the rescission. The validity of the rescission depending on whether the funding agreement constituted a 'financial product', such that a person dealing in that product would be providing a financial service, by virtue of section 766A(1)(b) of the *Corporations Act*, and therefore required to hold an AFSL.

---

[9] Judgment was delivered in October 2010: *Chameleon Mining NL v Murchison Metals Limited* [2010] FCA 1129

## Relevant definition of 'financial product' under the *Corporations Act*

The definition of 'financial product' in section 763A(1) includes:

> '... a facility through which, or through the acquisition of which, a person does one or more of the following:
>
> ...
>
> (b) manages financial risk...'

Section 763C provides, inter alia, that:

> '... a person manages financial risk if they:
>
> (a) manage the financial consequences to them of particular circumstances happening ...'

A product that would otherwise be a financial product is excluded if its role as a financial product is incidental to the main purpose: section 763E.

A product is excluded if it is a credit facility: section 765A(1)(h)(i).

## At first instance and in the Court of Appeal

Hammerschlag J held that the funding agreement was not a financial product, stating that on no realistic view could it be said that it was a financial product by which Chameleon managed financial risk[10].

Hammerschlag J found that ILP was entitled to the 'early termination fee' of $9 million, but not to the 'funding fee'. ILP appealed in relation to the second finding, and Chameleon cross-appealed in relation to the first.

On 15 March 2011, the NSW Court of Appeal handed down its decision, in which it unanimously disagreed with Hammerschlag J on the question of whether the funding agreement was a financial product[11]. Giles, Young and Hodgson JJA held that it was a financial product, as it was a facility through which Chameleon managed financial risk.

The three appeal judges did not reach a common view on other questions in the case.

Hodgson JA thought the financial risk management component of the funding agreement was only incidental to the agreement's main purpose, which was to provide funding for the proceedings against Murchison. Giles and Young JJA, on the other hand, thought the financial risk management component was not incidental .

Hodgson JA also thought the funding agreement was a credit facility and therefore excluded from the definition of financial product. Again, Giles and Young JJA differed.

Chameleon had raised a further argument that the funding agreement was a 'derivative', within the meaning of section 761D of the *Corporations Act*, and therefore specifically included in the definition of a financial product in the Act. Giles JA accepted this submission, but Young and Hodgson JJA did not.

The Court of Appeal therefore held, by majority, that the funding agreement was a financial product for which ILP needed an AFSL and that the rescission by Chameleon was valid.

The decision was seen as leaving unlicensed litigation funders potentially vulnerable to rescission of their funding agreements without redress, apart perhaps from repayment of funds already provided, such as legal costs incurred.

Following the decision, on 23 June 2011, ASIC issued Class Order 11/555, which extended Class Order 10/333 to exempt all litigation funding arrangements and proof of debt funding arrangements, including a single member arrangement, from the requirements of the Corporations Act in relation to financial products.

## Grant of special leave

On 28 October 2011, the High Court (Gummow, Heydon and Bell JJ) granted special leave to ILP to appeal.

---

[10] *Chameleon Mining NL v International Litigation Partners Pte Limited* [2010] NSWSC 972 at [81]

[11] *International Litigation Partners Pte Limited v Chameleon Mining NL* [2011] NSWCA 50

Comments from the Bench during the special leave application demonstrate the significance which the Court places on the issue. Notably, Gummow J said:

> 'This question of licensing litigation funders has to be an important one.'

It was argued, in opposition to the grant of special leave, that at least two of the questions which had to be answered were necessarily specific to the funding agreement in question, and hence there was no general question for the Court to answer in simple terms as to whether litigation funding businesses require an AFSL. It was also argued that as the matter was before the Executive (presumably a reference to the draft regulations referred to below) and the Executive knew what the Court of Appeal thought the legislation means, the Executive could either leave things there or take its own course. These submissions did not dissuade the Court from granting special leave.

In granting special leave, the High Court has signalled that it intends to determine the question of whether litigation funders are dealing in the sort of product which warrants formal regulation, and that it considers the question to be one of importance.

The hearing is likely to take place in the first half of 2012, and a decision may be expected towards the middle of the year.

## Proposed legislative reform

Litigation funding, which has been on the agenda of the Standing Committee of Attorneys General for some years as part of the broader topic of access to justice, remains the subject of formal review.

On 27 July 2011, as foreshadowed in the wake of *Brookfield Multiplex*, the Federal Government released an exposure draft of amendments to the Corporations Regulations for funded class actions[12]. In doing so, the Government confirmed its support for class actions and litigation funders as providers of access to justice for consumers, and indicated that it has decided that it cannot justify burdening them with compliance obligations. Coming as they did after the NSW Court of Appeal's decision in *Chameleon Mining*, the draft amendments also seek to address the financial product issue.

The proposed amendments would, among other things, carve out litigation funding schemes from the definition of a managed investment scheme, and exempt anyone providing a financial service in relation to a litigation funding scheme from the requirement to hold an AFSL and from other obligations under Chapter 7 of the *Corporations Act* (including disclosure and reporting requirements). The exemptions would be conditional on there being adequate arrangements in place to identify and manage conflicts of interest, reflecting awareness on the part of the Government of concerns about litigation funders' interests differing from those of their clients.

Treasury received six written submissions in relation to the exposure draft[13]. One submission came from a litigation funder, with two more coming from lawyers acting for claimants in funded litigation. Treasury is in the process of considering the submissions and may issue a re-draft.

Now that special leave has been granted in *Chameleon Mining*, the Government may await the High Court's decision before proceeding with its reforms. If so, the existing interim relief (which applies until 29 February 2012) is likely to be extended again in the meantime.

November 2011

This article was prepared by Dougal Langusch, Senior Associate and Kathryn Rigney, Director. Kathryn Rigney can be contacted on 9231 7027 or at krigney@ypol.com.au and Dougal Langusch can be contacted on 9231 7016 or at dlangusch@ypol.com.au

[12] http://www.treasury.gov.au/contentitem.asp?NavId=037&ContentID=2104

[13] http://www.treasury.gov.au/contentitem.asp?ContentID=2140&NavID=037

On 1 September 2007, three of the leading insurance and commercial litigators of Phillips Fox joined forces with the established and respected insurance and commercial litigation specialist, Yeldham Lloyd Associates to create our firm.

On 5 May 2008 we enhanced our capability and commitment to the insurance and reinsurance industry with the addition of a specialist corporate and regulatory team.

We are a specialist incorporated legal practice. We are focused on insurance, reinsurance and commercial litigation.

Our directors are recognised locally and internationally as among the best in their fields. They are supported by an experienced and talented team.

We are accessible, straightforward and responsive. We are about providing the best legal service at a reasonable cost.

For more information on our firm please visit www.ypol.com.au

LEVEL 2, 39 MARTIN PLACE
SYDNEY NSW 2000

DX 162 SYDNEY

T: +61 2 9231 7000
F: +61 2 9231 7005
WWW.YPOL.COM.AU

YPOL PTY LTD TRADING AS
YELDHAM PRICE O'BRIEN LUSK
ACN 109 710 698



**DISCLAIMER**

This paper was prepared by YPOL (Dougal Langusch).

This update is intended to provide a general summary only and does not purport to be comprehensive. It is not, and is not intended to be, legal advice.