Maintenance, Litigation Funding and Representative Actions

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The law on maintenance and champerty and the issue of whether certain litigation funding arrangements justified a permanent stay of representative proceedings were considered recently by the NSW Court of Appeal. In *Fostif Pty Ltd v Campbells Cash & Carry Pty Ltd*[1]. The judge at first instance had ordered a permanent stay of 17 separate proceedings commenced under the NSW Supreme Court representative action rule[2] on behalf of various tobacco retailers seeking to recover licence fees paid to tobacco wholesalers pursuant to legislation subsequently found to be invalid[3]. The proceedings, which were commenced shortly before the expiry of the relevant limitation period, were funded by companies in the business of providing accountancy services. Separate representative actions were commenced on behalf of numerous groups of tobacco retailers. Those who wished to continue the conduct of the proceedings on their behalf were required to "opt-in" to the proceedings and become named plaintiffs.

After commencement of the proceedings, the lead plaintiffs sought orders for discovery of the names of the other members of the class of retailers so as to facilitate the sending of "opt-in" notices to the persons identified.

The trial judge dismissed the application and ordered that the proceedings not continue as representative proceedings, including on the basis that the represented retailers did not have the requisite "*same interest"* required by the Rules and also because the proceedings were considered to be an abuse of process in respect of their purported representative nature.

In overturning the decision of the primary judge, the NSW Court of Appeal[4] held that the representative actions were not an abuse of process and that the permanent and unconditional stay of proceedings was not justified.

Aspects of the decision dealing with the effect of the commencement of representative proceedings on the operation of limitation periods are not dealt with in this article.

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[1] [2005] NSWCA 83
[2] Part 8, Rule 13
[3] *Ha v State of NSW* (1997) 189 CLR 465; *Roxborough v Rothsmans of Pall Mall Australia Ltd* (2001) 208 CLR 516
[4] Mason P, Sheller JA and Hodgson JA agreeing

The Court of Appeal made a number of important observations concerning the operation of the representative action rule. These are not dealt with in detail in this article. Those aspects of the decision concerning litigation funding arrangements are discussed below.

Mason P reviewed the recent authorities in relation to champerty and the evidence in the present proceedings concerning the nature of the litigation funding arrangements which had been entered into. He concluded that champerty or third party assistance per se, do not constitute abuse of process. On the evidence, neither the solicitor's retainer nor the role of the litigation funder revealed the actuality or tendency of abuse of process. It was also held that the activities of the litigation funder did not constitute "trafficking in litigation", contrary to the findings of the primary judge.

The judge at first instance, Einstein J, had held that the mere involvement of the litigation funder did not of itself render the proceedings champertous or an abuse of process, but concluded that a combination of factors, including the size of the funder's anticipated profits, the structuring of relationships between the clients, the solicitors and the litigation funder led to his conclusion that the representative proceedings were an abuse. The proposed distribution of "opt-in" notices was held by Einstein J to constitute trafficking in litigation.

At the commencement of the representative proceedings, some 2,100 tobacco retailers had already agreed to proceedings being brought on their behalf. The number of potential claimants was estimated to be 10,000 with a likely average of $4,000 per claimant.

In the Court of Appeal, Mason P considered the role of the litigation funder, Firmstone. Firmstone was:

> "*responsible for overall project management as well as strategic and technical issues, appointment of legal representatives, funding any legal proceedings and/or dealings with tobacco suppliers and government organisations*" (at para 51)

This included providing the retailers with contractual indemnity against the risk of any adverse costs orders and providing any security for costs which might be ordered.

Ancillary tasks in connection with the litigation were provided by another company, Horwath DST Pty Ltd, in consideration of a 50% share of the 33□% fee proposed to be charged and calculated with reference to what the represented retailers recovered by way of any settlement of judgment in the representative proceedings.

Firmstone retained the solicitors for the project who appeared on the record to represent the retailers and to provide advice to Firmstone.

The funder's role also encompassed conducting negotiations on behalf of represented tobacco retailers, including in relation to settlement of their claims.

The proceedings in question in this case followed numerous other proceedings which had been brought by other tobacco retailers against various tobacco wholesalers and which had been largely successful. Following the resolution of such other claims, the representative proceedings were a:

> "*Last ditch effort for all their existing and anticipated clients to be able to recover on what, by this stage appeared to be well established causes of action which had, to date, always culminated in favourable settlements…"* (at para 57)

In addition to the abovementioned "success fee" of one-third of any monies recovered in respect of tobacco licence fees, including interest thereon, the funders claimed entitlement to also receive any court ordered costs as a contribution toward the costs advanced by the litigation funders in conducting the proceedings.

At first instance, Einstein J was concerned about the nature and extent of "control" over the litigation given to the litigation funders and ultimately concluded that the firm's activities constituted "trafficking" in the retailer's litigation. His Honour concluded that the litigation funders had an opportunity to abusively influence the conduct of the proceedings. Of particular concern was the apparent "monopoly" that was enjoyed by the litigation funder given the expiration of the relevant limitation period shortly after the various representative proceedings were commenced.

Einstein J also made a number of adverse findings about the role of the solicitor and the "irregularities" in the retainer between the solicitor, the litigation funder and the client.

The matters which were of particular concern to Einstein J encompassed: (a) the alleged lack of communication between the solicitors and the plaintiffs; (b) the tenuous relationship between the plaintiffs and the solicitors on the record (c) the engagement of the solicitors by the litigation funder as principal rather than as agent for the clients of the litigation funder; (d) the contractual constraint upon direct communication between the solicitor and the plaintiff; (e) potential conflicts of interests between the interests of the litigation funder, the interests of the plaintiffs or the target "opt-in" group (including in respect of settlement, the conduct of the proceedings, and the level of expenditure on legal fees); and (f) potential problems in relation to discovery obligations.

In the Court of Appeal, Mason P, *inter alia* (a) accepted the evidence of the solicitors that they never intended to abrogate any right of direct communication with the tobacco retailers; (b) saw nothing wrong in principle with the arrangements for control and communication with clients as such arrangements had the "*informed consent of the ultimate client*" (at para 82); and (c) was of the view that there was no finding or basis on the evidence for a finding that the retainer had a tendency towards abuse of process. The settlement conflict of interest scenarios hypothesised by Einstein J were said to be "*speculative and far-fetched*" (at para 83).

On the evidence, Mason P was satisfied that the solicitor had in fact communicated directly with clients and that such correspondence (a) demonstrated both awareness

of and attention to professional obligations (at para 84); and (b) indicated a meticulous concern to ensure compliance with obligations in respect of discovery and notices to produce documents (at para 85). Moreover, Mason P was of the view that the evidence revealed that the solicitor (a) had accepted the normal role as a solicitor on the record in litigation (b) was not obligated to interview retailers personally (at least at that stage of the proceedings) and (c) was not shown to have departed from his responsibility as an officer of the court. According to the Court of Appeal, not only was there no basis for the finding that the solicitor's conduct would bear on the actuality or tendency for abuse, the role of the solicitor should have been "*placed in the scales against findings of abuse and tendency to abuse directed at*" the litigation funder (at para 87).

In his judgment, Mason P proceeding to examine in some detail: (1) the issue of maintenance and champerty in the context of litigation finance arrangements; (2) litigation finance arrangements and the notion of abuse of process; (3) issues of public policy and litigation funding arrangements; (4) the notion of "trafficking in litigation"; and (5) the question of whether or not the funding arrangements were unjust from the defendants' perspective.

Each of these issues is considered in further detail below.

1. Litigation funding arrangements and the law on maintenance and champerty

In NSW, the *Maintenance and Champerty Abolition Act 1993* abolished both the crime and the tort of maintenance, including champerty. However, the legislation preserves the operation of laws which may render any contract contrary to public policy or otherwise illegal. Thus, as Mason P noted, litigation funding arrangements made without express statutory authority are still subject to scrutiny if their validity is challenged (at para 93). However, according to Mason P, it is not correct to:

> "*Conflate the principles of maintenance/champerty with those touching abuse of process, or view them as arming a defendant with a right to stay proceedings because they are maintained (even champertously).*" (at para 93)

Mason P noted that even in jurisdictions where, unlike in NSW, the crimes and torts of maintenance/champerty have not been abolished, modern common law courts have adopted a more liberal approach to third party funding of litigation, particularly given concerns about access to justice and the heightened awareness of the cost of litigation. (paras 94-101)

His Honour referred to a number of recent English and Canadian authorities.

In the Australian context, Mason P distinguished the decision in *Clairs Keeley* (a Firm) *v Treacy*[5]. That case was distinguishable from the present proceedings because (a) at common law and maintenance and champerty continues to operate in Western Australia; (b) the causes of action in that case were incapable of

[5] [2003] 28 WAR 139 (*Clairs Keeley* (No.1))

assignment, although there was purportedly a "de facto assignment" of such cause of action; (c) there was non disclosure of an important aspect of the arrangements between the funder and the solicitor; and (d) the solicitor's role was found to entail a position of conflict and breach of fiduciary duty. Notwithstanding these findings by the WA Supreme Court, in that case, the stay ordered was only conditional.

In the present proceedings, Mason P concluded that the judge at first instance had erred by focusing on the funder's champertous intermeddling and the common law policies proscriptive of the tort of champerty notwithstanding the primary judge's acknowledgment that champerty, per se, did not amount to an abuse of process.

As noted by Mason P, the additional "vice" of champerty, as compared with maintenance, arises out of the sharing of the proceeds of litigation with the litigation funder (see, for example, para 115). According to Mason P:

> "*… a profit motive is no longer the touchstone of illegality, even at common law.*" (at para 116)

Mason P acknowledged that the desire for a "success fee" may have a tendency to corrupt processes, which tendency may be greater if the fee is higher and the activity is unregulated (at para 116). However, as Mason P proceeded to note, such a finding should focus clearly on the dangerous tendency, not the profit as such. Moreover, as his Honour noted, there were various other statutory and other mechanisms for dealing with any perceived or actual problems, without requiring a permanent stay of the proceedings. Such regulatory mechanisms included the following:

(1) section 6 of the *Maintenance and Champerty Abolition Act* 1993 preserves in NSW, the effect of any law in respect of cases in which the funding contract is to be treated as contrary to public policy or otherwise illegal;

(2) the provisions of the *Contracts Review Act* 1980 (NSW) may prevent unconscionable exploitation of the vulnerable;

(3) legal practitioners are accountable professionally for their conduct; and

(4) representative proceedings are subject to judicial control.

Therefore, according to Mason P:

> "*In general, it is simply no business of a defendant to be taking up the cudgels on behalf of the funded litigants who are either parties or represented persons, invoking interlocutory processes ostensibly on behalf of the funded litigants but in reality in its own interest. As this appeal demonstrates, such satellite proceedings have the capacity of diverting resources and attention from the true issues as between the plaintiffs (and those they represent) and the defendant*" (para 119)

As his Honour proceeded to note, defendants may in proper cases, seek security for costs or obtain special costs orders against funders if the proceedings fail (at para 120).

The existing regulatory and control mechanisms provide a means of dealing with any actual problems which may occur which may have an adverse impact on either the represented persons or the defendants of the litigation. Accordingly, the law on maintenance and champerty, per se, does not give rise to any impediment to litigation finance arrangements of the type in question in the present proceedings, even in jurisdictions where the crimes and torts of maintenance and champerty have not been abolished by statute.

2. Litigation funding arrangements and abuse of process

In the earlier *Clairs Keeley* proceedings as Mason P noted, the Full Court of the Supreme Court of Western Australia[6] concluded that the funding arrangement in that case was champertous and contrary to public policy. What was said to be a de facto assignment of cause of action to the funder was also held to be in effect, trafficking in litigation. According to the Full Court of the Supreme Court of Western Australia:

> *"It is acceptable for the litigation to be pursued by plaintiffs who, although funded by a third party, are acting in their own interests in the pursuit of justice in their respective causes, and are so acting on the advice of independent solicitors. It is not acceptable for the litigation to be pursued in such a way that the interests of the plaintiffs are subservient to those of the funder. That would be an abuse of process."* (referred to by Mason P at para 113).

In the NSW Court of Appeal, Mason P indicated that he disagreed with the "*categorical thrust of the last two sentences*" (at para 114). According to Mason P:

> "*In my opinion, a conclusion about abuse of process must stem from a finding directed at the actual or likely conduct of the party in whose name the litigation is brought (or its agents). The court is not concerned with balancing the interests of the funder and its clients. Indeed, it is not concerned with the arrangements, fiduciary or otherwise, between the plaintiff and the funder except so far as they have corrupted or have a tendency to corrupt the processes of the court in the particular litigation. It is only when they have that quality that the defendant has standing to complain about them"* (at para 114)

As noted above, in the NSW proceedings, one matter of concern to the primary Judge was the commencement of proceedings just prior to the expiration of the relevant limitation period, thus in effect, creating a purported "monopoly" for the litigation funder. Tobacco retailers who declined to participate in the litigation, on the terms proposed, arguably lost any right to pursue claims against the tobacco wholesalers. As noted below, this appears to be misconceived.

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[6] Steytler, Templeman and McKechne JJ

As noted by Mason P, it is difficult to perceive the evil of any consequence for those who choose to abandon their right to seek recovery (at para 125). On the "*opposite side of the coin*", claims which would have otherwise become statute barred were open to be pursued on behalf of retailers who elected to pursue them. Such considerations were considered by Mason P to be irrelevant to the abuse of process enquiry. According to Mason P:

> "*… the court's power to stay for abuse of process is not based upon solicitude for the economic interest of those maintained by the funder".* (at para 125)

However, as Mason P proceeded to note, the court has power to impose conditions upon granting or continuing its permission for representative proceedings to go forward. The power to "otherwise order" may be used as the basis for ensuring that the matters proceed fairly as regards all members of the group and this power extends to modifying the funder's proposed terms as to the basis of its support for retailers who opt-in (para 126).

Mason P noted that the individual claims of the retailers were legally viable. Thus, the orders which under appeal had effectively closed off causes of action which had been genuinely advanced and had good prospects, where a substantial number of people had already confirmed their desire to proceed in circumstances where it may be inferred that many others would do likewise when notified (at para 130). Moreover, many individual retailers would be likely to be deterred from bringing separate individual claims as plaintiffs.

Accordingly, Mason P concluded that:

> "*… the court's basal inquiry should be whether the role of the particular funder has corrupted or is likely to corrupt the processes of the court to a degree that attracts the extraordinary jurisdiction to dismiss or stay permanently for abuse of process. The standard of proof is high where (as here) the plaintiff has a genuine and viable cause of action. The court will lean in favour of moulding its remedy so as to eliminate the abuse, resorting to dismissal only as a last resort where this is impossible." (at para 132)*

On the evidence in the case on appeal, Mason P noted that:

(1) no abuse had occurred to date; (2) the proceedings were in proper form; (3) the matter had been placed under judicial scrutiny at the earliest opportunity; (4) the conditions under which the proceedings were to go forward had been submitted to the court; (5) there was no suggestion that the retailers had been misled about the arrangements under which the litigation was proposed; (6) there was no evidence as to any existing conflict of interest between the funder and the retailer; and (7) there were no suggestions of any misrepresentations of fact or law in the advertising material from the funder or in the opt-in notices (at para 133).

Mason P was unpersuaded as to the relevance or force of the primary judge's findings about various matters which individual retailers had apparently not been advised or informed about. As his Honour noted:

> "*It is not a prerequisite of representative proceedings being instituted or continued that the represented persons are consulted about the conduct of the proceedings, or even have knowledge or them (Mobil Oil Australia Pty Ltd v Victoria (2002) 211 CLR 1 at 21 [6], 29[33], 39[65], Arakella v Paton (2004) 60 NSWLR 334 at 349[65])"* (at para 134)

Other arguments sought to be relied upon by the respondents to the appeal were said to be irrelevant to lacking in substance. These included the prospect that the litigation funder might not be able to honour its obligations in relation to meeting orders for costs, with the consequence that the retailers might end up paying costs personally. However, there was no evidence that the funders did not have the requisite financial capacity and they had already offered $1 million as security for costs (para 135).

Potential conflicts of interest between the funder and the represented group members were said to arise in most types of representative proceedings (at para 136).

Contentions as to the potential for conflict of interests arising out of the "control" exercise by the litigation funder were said to be a non-sequitur (at para 137).

Although expressing doubts about "judicial paternalism" in the context of the present case, Mason P noted that a "*measure of control is essential if the funder is to manage group litigation and also to protect its own legitimate interests*". (at para 137)

The degree of control by the funder was found not to be excessive, especially given that there was a solicitor on the record and proceedings were being conducted under judicial supervision.

The funder had obtained express written authority from each group member to proceed as it was doing[7]. Moreover, according to Mason P:

> "*One suspects that* [the funder] *is much better placed than individual retailers to make the forensic decisions necessary to deal with determined and well-informed opponents …*" (at para 137)

Although there was a need for judicial vigilance to deal with situations of conflict, Mason P concluded that this was, of itself, not a basis for abuse of process meriting an unconditional stay of the representative proceedings (at para 138).

As his Honour noted, one area of potential difficulty is where the funder has to address a settlement offer that treats all members of the class identically when there are in fact differences in the strength of individual claims (at para 138). Similar problems would also arise where the proposed settlement treated similarly situated group members differently.

In the present case, the representative plaintiffs had given authority to the funder to have the carriage of the litigation, including decision-making as to the basis upon

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[7] para 137

which the proceedings may be settled, without any obligation to consult individual retailers. Mason P saw no reason why this agreement could be challenged by the respondents (at para 139).

The finding that the funders fee was "*inordinately high*" was a factor relied upon by the judge at first instance. On this issue, Mason P noted that:

> "*there is little enunciation in the caselaw of the relevance of examining the rate of the funder's return in the context of abuse of process".* (at para 142)

In considering this, reference was made to other litigation funding arrangements and evidence that the funder's percentage in the present case was not "*demonstrably outside some sort of general market rate*" (para 144).

Of more significance in the Court of Appeal were the appellant's arguments about the paucity of the judge's reasons justifying his conclusion about the "*inordinate*" size of the fee and the relevance of such finding.

Mason P adopted, as a starting premise:

> "… *the proposition that the Court should not lightly interfere with the autonomy of the funded clients, absent evidence of misleading or deceptive conduct on the part of the funder or oppression or misuse of the powers conferred by contract on the funder. This has even greater force where the funder uses a solicitor and submits itself to judicial supervision by invoking the processes of the Court through the application by the lead plaintiffs for orders under the Rule."* (at para 146)

His Honour proceeded to consider "*cost/benefit*" issues in the context of the "*large, hugely expensive nature*" of proceedings such as the present. His Honour was of the view that it was:

> "*… inconceivable that individual plaintiffs with an average claim of $1000 or perhaps a little more would hazard the litigious risks and costs involved of taking on these determined and experienced defendants in separate proceedings. There may be some, but they would be very exceptional, in my view."* (para 149)

Moreover, there was no evidence that the negotiated consideration payable by the funded retailers is likely to exceed the costs payable on a "do and charge basis" if each retailer had sued separately and the solicitor had engaged the funder to do the "leg work" (para 150).

His Honour noted that the standard of proof for establishing abuse of process and thereby obtaining summary dismissed or permanent stay of the proceedings is a high one particularly given that questions of access to justice were involved.

Mason P concluded that Einstein J had erred in his conclusion that there was an established abuse of process arising out of the fee arrangements entered into

between the funder and its clients. The other matters sought to be relied upon by the judge at first instance did not justify his conclusion either (at para 152).

On the issue of the alleged "monopoly" conferred upon the litigation funders by virtue of having instigated the representative proceedings prior to the expiration of the relevant limitation period, it is not clear why persons who had had proceedings commenced on their behalf could not seek to become plaintiffs either in the primary proceedings or by way of severance of their claims from the primary proceedings, without being obliged to enter into the proposed litigation funding arrangements. Given these options, the alleged "monopoly" would appear to be illusory rather than real.

3. Funding arrangements and public policy

In the first instance, Einstein J invoked considerations of "public policy" as an independent basis for the permanent stay imposed. In the Court of Appeal, Mason P found that the reasons which his Honour had in mind encompassed the champertous funding arrangements and the statutory reservation of public policy as a basis for challenging contractual arrangements[8]. Mason P was of the opinion that it is "*dangerous to move beyond the scope of the reservation(s) without very clearly identifying some alternative ground for invoking public policy*" (at para 105).

According to Mason P, public policy was now more narrowly confined and "*the law now looks favourably on funding arrangements that offer access to justice so long as any tendency to abuse of process is controlled…*" (at para 105)

His Honour adopted (at para 105) the principle recently stated by the Master of the Rolls in the English Court of Appeal:

> "*Public policy now recognises that it is desirable, in order to facilitate access to justice, that third parties should provide assistance designed to ensure that those who are involved in litigation have the benefit of legal representation*"[9].

4. Litigation funding arrangements and trafficking in litigation

In the Court of Appeal, Mason P was of the view that the concept of trafficking in litigation is elusive, particularly in light of the currently relaxed common law attitude to litigation funding (at para 107).

His Honour referred with approval to the distinction drawn by Staughton J[10] between "*selling lawsuits as activities of commerce"* and *"taking an assignment in a case where one has a genuine commercial interest*". As Mason P noted, the concept of trafficking in litigation adopted by the English Court of Appeal encompassed

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[8] Section 6 *Maintenance and Champerty Abolition Act* 1993

[9] *Gulfazov Shipping Co Ltd v Idisi* [2004] EWCA 92

[10] *Kaukomarrkinet O/Y the "Elbe" Transport-Union GMBH (The "Kelo")* [1985] 2 Lloyds Rep 85 referred to by Mason P at para 27

"*unjustified buying and selling of rights to litigation where the purchaser has no proper reason to be concerned with the litigation*"[11].

As noted by Mason P, Lord Mustill in *Giles v Thompson*[12] adopted the description of the policy underlying the former criminal and civil sanctions against champerty expressed by Fletcher Moulton LJ as *"…directed against wanton and officious intermeddling with the disputes of others in which the [maintainer] has no interest whatever, and where the assistance he renders to one or the other party is without justification of excuse*"[13].

As noted above, at first instance in *Fostif*, Einstein J was of the view that the proposal by the litigation funders to distribute "opt-in" notices under the court's direction would involve trafficking in the retailers' litigation which was said to constitute an abuse of process. In the Court of Appeal, Mason P came to a different conclusion. According to his Honour, this was "*not a case whose facts engaged any residual category of trafficking (if it truly exists in the State)*" (at para 122). According to his Honour, the litigation funders' lack of independent interest in the proceedings and the firm's profit motive did not establish champerty in the modern law, let alone abuse of process (at para 122).

Other factors taken into account by Einstein J, including the role of the solicitors, were also rejected by Mason P.

The concerns expressed by the primary judge about the level of awareness of the retailers about their role in the litigation were, if relevant to abuse of process, considered by Mason P to be either not substantiated or remediable by a less drastic remedy than a permanent stay (at para 122).

In the present case, Mason P also (tentatively) noted that the retailers' causes of action were for money had and received which was historically a claim in debt. According to his Honour:

> "*Debts are readily assignable, even to those who hope to recover more than they pay the assignor, without apparently engaging the principles about trafficking"* (at para 123, omitting the authorities cited)

5. Litigation funding arrangements and unjustness from the defendant's perspective

In the Court of Appeal, Mason P was of the view that the Overriding Purpose Rule[14] did not provide an independent basis for a stay in matters such as the present where none would otherwise exist (at para 106). According to his Honour, the defendant

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[11] *Stocznia Gdanska SA V Latreefers Inc (No 2)* [2000] EWCA 17, [2001] 2 BCLC 116 referred to by Mason P at para 111

[12] [1994] 1 AC 142 at 161

[13] *British Cash & Parcel Conveyors Ltd v Lamson Store Service Co Ltd* [1908] 1 KB 1006, 1014 referred to by Mason P at para 112

[14] Part 1 Rule 3 *NSW Supreme Court Rules*

had no claim in “justice” to avoid otherwise viable proceedings simply because a plaintiff receives assistance and encouragement from a third party litigation funder (at para 106).

Of course, the defendants were in a much more commercially financially advantageous position under the litigation funding arrangement, given that the funder was contractually obligated to not only provide security for costs but also to indemnify the retailers in the event of any adverse order for costs made in favour of the defendants in the litigation.

6. Conclusion

This decision is of considerable significance in connection with civil litigation generally and class action litigation in particular. In Federal Court class action proceedings, private litigation funding arrangements have become more common in recent years. Such funders have filled the void left by (a) the failure of the Federal Government to implement the recommendations of the Australian Law Reform Commission for the establishment of a class action fund and (b) the unavailability of adequate legal aid. The decision under review is likely to encourage (a) private litigation funders and (b) greater use of the representation action rule. This will facilitate greater access to justice.