THE LAW SOCIETY OF NEW SOUTH WALES
young LAWYERS

Civil Litigation Committee

Preliminary Submissions regarding the New South Wales Law Reform Commission reference into security for costs and associated orders

16 February 2010

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Summary of preliminary submission

The NSW Young Lawyers' Civil Litigation Committee (**the Committee**) comprises young lawyers, either under the age of 36 or in their first five years of practice and law students, all of whom practise or have an interest in civil litigation.

The Committee has had an opportunity to read and consider the terms of reference received by the Law Reform Commission on 8 December 2009 (**the Terms of Reference**) and is pleased to provide its preliminary submissions in response to the invitation to do so from the Honourable James Wood AO QC by letter dated 11 December 2009.

The Terms of Reference include a request for the Law Reform Commission to:

"inquire into and report on whether the law and practice relating to security for costs and to associated orders... strikes an appropriate balance between protecting a plaintiff's right to pursue a legitimate claim regardless of their means against ensuring that a defendant is not unduly exposed to the costs of defending that litigation. In undertaking this review, the Commission is to consider in particular whether or not the law and practice:

...

d) operates appropriately... where parties are funded by third parties

...

the Commission is also to consider whether the Uniform Civil Procedure Rules 2005 in relation to Security for Costs and associated orders are adequate, and any related issues."

The Committee considers that litigation funded by third parties, or "litigation funding", presents a challenge to civil law and procedure that has yet to be satisfactorily addressed.

Historically, entering into litigation funding agreements (**LFAs**) would have constituted the offences of both champerty and maintenance, and would have given rise liability in tort. These offences and torts existed to protect against the dangers of encouraging unmeritorious litigation. In contemporary times, chief among the dangers of encouraging unmeritorious litigation is the increased risk of successful defendants receiving costs orders against plaintiffs who cannot comply with the order.

Relatively recently, it has become clear that litigation funding does not now, of itself, constitute an abuse of process and that litigation funding agreements (**LFAs**) are not void as being against public policy. In the Committee's view, the use of litigation funding will continue to increase. The Committee accepts that there are strong public policy reasons for accepting a role for litigation funding in New South Wales.

However, it is important not to lose sight of the fact that, despite the legalisation of litigation funding, some dangers presented by the practice of litigation funding still subsist. Accordingly the Committee is of the view that civil procedure needs to be amended to protect, where possible, against the risk that successful defendants will be unable to enforce costs orders against plaintiffs funded by litigation funders.

The Committee believes that the following are gaps in the law with respect to litigation funders which can and should be rectified by appropriate legislative amendments:

Successful defendants who cannot enforce costs orders against plaintiffs who are funded by litigation funders cannot obtain the unpaid balance of their costs orders from the litigation funder; and

Security for costs orders made directly against individual plaintiffs who are funded by litigation funders are made using the court's inherent jurisdiction to make orders for security for costs, rather than, as is more common, under the statutory powers to do so.

In order to remedy these problems, the Committee suggests that the *Uniform Civil Procedure Rules 2005* (**UCPR**) be amended to:

provide the Court with jurisdiction to make costs orders against a litigation funder;

require plaintiffs who are assisted by a litigation funder to provide the Court and the defendant with a deed pursuant to which the funder indemnifies the plaintiff against any adverse costs order that may be made against the plaintiff; and

provide the Court with a statutory jurisdiction to make security for costs orders against individual plaintiffs funded by litigation funders.

The above amendments are dealt with in more detail below.

The Committee is of the view that these suggested amendments to the UCPR fall within the scope of the Terms of Reference. Although amendments 1 and 2 do not deal with 'security for costs orders' in the normal sense those words are used, the rationale for both of these amendments is to help ensure that successful defendants are not burdened by costs orders that cannot be enforced.[1] This is identical to the rationale for security for costs orders. Accordingly, the Committee considers that these suggested amendments are within the scope of the Terms of Reference, in that they deal with "the law and practice relating to security for costs," and "the law and practice relating to orders associated to security for costs orders" or at the very least with "related issues" as per paragraph ii) of the Terms of Reference.

[1] *The Australian Derivates Exchange Ltd v Doubell* [2008] NSWSC 1174 at [13]; *Ritchie's Uniform Civil Procedure NSW*, Peter Taylor SC ed, 42.21.5.

Preliminary submission

1. Introduction – issues in litigation funding

A recent decision of the High Court of Australia has shown that the law and practice in New South Wales relating to security for costs and associated orders is demonstrably inappropriate where parties are funded by third parties (**litigation funders**). In short, they are inappropriate in two ways.

The first is that they allow litigation funders to walk away, liability-free, from proceedings that they fund even where a successful defendant has a costs order against the funded plaintiff that cannot be paid. The second is that the jurisdiction to make security for costs orders against individual plaintiffs who are supported by litigation funders is not in line with the normal jurisdiction for making costs orders under the *Uniform Civil Procedure Rules 2005* (**UCPR**).

2. The costs of successful defendants in funded matters – who foots the bill?

The Committee notes that the High Court case of *Jeffery & Katauskas Pty Limited v SST Consulting Pty Ltd* [2009] HCA 43 (***Jeffery & Katauskas***) established the rule that litigation funding is not of itself an abuse of process, even where the funder does not grant the funded party an indemnity for adverse costs orders. Rule 42.3 of the UCPR provides that the court has no jurisdiction to make costs orders against a non-party, but an exception to that rule is that non-party costs orders can be made in circumstances of abuse of process. As the court in *Jeffery & Katauskas* held that a funder's failure to provide a costs indemnity was not abusive of process, the High Court ruled that the Supreme Court of New South Wales did not have jurisdiction to order costs against the funder, being a non-party.

A. Problems associated with not requiring funders to give costs indemnities

The Committee notes that the practical impact of the *Jeffery & Katauskas* decision is that, as occurred in *Jeffery & Katauskas* itself, a defendant may receive a costs order against a plaintiff, and if the amount of the costs order is greater than the costs the plaintiff can pay, the defendant will not be able to recover the balance of the costs order from the litigation funder.

Of course, in litigation, there is often a danger that successful defendants will not be able to receive the entirety of their costs orders. The security for costs regime exists to give defendants some protection in this regard, but often, the security given does not match the amount of the costs order.

However, it is a failing of our civil justice system for this to occur where there is a funder involved. The Committee notes that the failing arises as:

(i) it is unjust for litigation funders to enable the litigation, with a view to a profit, and be able to walk away without repercussions, when making profits is not the goal of the legal system; and

(ii) litigation funders are, in some respects, a party to the litigation through their control of proceedings.

(i) Profit is not the primary goal of the legal system

As noted by Hodgson JA (at [51]) in *Green (as liquidator of Arimco Mining Pty Ltd) v CGU Insurance Ltd* (2008) 67 ACSR 105 (***Green***), and approved by the High Court in *Jeffery & Katauskas* ([35]; [69]), the justice system is "primarily there to enable rights to be vindicated rather than commercial profits to be made". In the Committee's view, it is both anomalous and unjust that (under the current law) a funder is able to encourage litigation by a plaintiff, fund that litigation, and then walk away from the litigation whilst a successful defendant is potentially left out of pocket. It is an especially absurd situation that this is the case given that making a profit is certainly not the primary goal of the justice system. If litigation funders are to be permitted to use the justice system, a public resource, as a tool of private profit, then the Committee is of the view that at the very least the law should be careful to minimise the detrimental effect of using the justice system for private profit, by protecting successful defendants.

In this regard, it should be noted that of course, the costs that unsuccessful plaintiffs are ordered to pay are almost always calculated on a party-party basis rather than an indemnity basis. Therefore even a fully satisfied costs order would not normally put a successful defendant back in the position in which it would have been but for the litigation.

(ii) Litigation funders are quasi-parties to the litigation

Further, the Committee notes that funders often have a very strong influence in how proceedings are to be conducted. Obviously, control of the litigation's purse strings provides the funder with power over important decisions in the litigation. Over and above that, large, commercial litigation funders may act as the architects of the litigation which they fund, and make day to day decisions regarding the conduct of the litigation. One of the factors often considered in making costs orders is indeed the way in which the proceedings were conducted. If proceedings are conducted in an inefficient or inexpedient manner, this can have a consequence in costs orders eventually made. Given that where litigation funders are involved in litigation, they will often have a strong influence over how proceedings are conducted, there should at least be a *possibility* that the court will make a costs order against the funder in appropriate circumstances. This would be more just, and would provide an incentive for the litigation funder to conduct the litigation sensibly, for fear of adverse costs orders against it.

Given the factors discussed above, it is anomalous that, despite the court's generally extremely wide discretion to make costs orders, they are not granted the jurisdiction to make costs orders against litigation funders.

Allowing this position to continue, in the Committee's view, risks exactly the dangers against which the offences of maintenance and champerty were supposed to guard: namely, encouraging trafficking in litigation, and encouraging unmeritorious litigation.[2] As Einstein J noted in *Green in his capacity as liquidator of Arimco Mining Pty Ltd (in liq) v CGU Insurance* [2008] NSWSC 449 at [26], the Court should be disinclined to "permit a win-win situation for an outside party: that is to say to permit a lender who stands behind the liquidator awaiting to benefit from a success in the proceedings to avoid having a fair responsibility for the costs of the liquidator in the event that the proceedings fail."

Accordingly, the Committee is of the view that litigation funders must be obliged to be the ultimate guarantors of any costs orders made against the party that it funds.

B. The common law has not adapted to address the challenge of litigation funding

The Committee notes that the High Court has decided that it has no basis on existing authorities to adopt the position that litigation funders must be ultimately responsible for costs orders made against the parties they fund. Given that the Court explicitly decided against adopting such a position in *Jeffery & Katauskas*, the High Court's position is considered in this section.

In *Jeffery & Katauskas*, the High Court stated that:

42. Once it is recognised first, that the UCPR precludes ordering costs against a non-party save in exceptional cases, and secondly, that the plaintiff's inability to pay costs goes only to questions of security, the appellant's contention that prosecution of the proceedings constituted an abuse of process can be seen to depend upon one of two propositions:

- a general proposition condemning the funding for reward of another's litigation;

- a proposition that despite the provisions and principles governing security for costs and the UCPR's general inhibition against ordering costs against non-parties, those who fund another's litigation for reward must agree to put the party who is funded in a position to meet any adverse costs order.

As discussed earlier in these reasons, a general proposition of the kind first mentioned is not consistent with what was decided in Campbells Cash and Carry Pty Ltd v Fostif Pty Ltd. *The second, more particular, proposition should not be accepted.*

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[2] See eg *Re Movitor Pty Ltd (in liq)* (1996) 64 FCR 380; *Findon v Parker* (1843) 11 M & W 675 at 682 – 683; and the overview of the history of champerty and maintenance in *Fostif* (2006) 229 CLR 386 at 426 – 431.

43. The proposition that those who fund another's litigation must put the party funded in a position to meet any adverse costs order is too broad a proposition to be accepted. As stated, the proposition would apply to shareholders who support a company's claim, relatives who support an individual plaintiff's claim and banks who extend overdraft accommodation to a corporate plaintiff. But not only is the proposition too broad, it has a more fundamental difficulty. It has no doctrinal root. It seeks to take general principles about abuse of process (and in particular the notion of "unfairness"), fasten upon a particular characteristic of the funding arrangement now in question, and describe the consequence of that arrangement as "unfair" to the defendant because provisions and principles about security for costs have been engaged in the case in a particular way and the rules will not permit the ordering of costs against the funder unless the principles of abuse of process are engaged. For the reasons stated earlier, that proposition is circular. And to point to the particular feature of a funding arrangement that the funder is to receive a benefit in the form of a success fee or otherwise, adds nothing to the proposition that would break that circularity of reasoning or otherwise support the conclusion that there is an abuse of process.

The two reasons that the High Court gives in the passage above for not accepting a proposition that "those who fund another's litigation must put the party funded in a position to meet any adverse costs order" are 1) that it is too broad, in that adopting such a bald proposition would cover persons who fund litigation who are not "litigation funders" in the relevant sense (such as banks who loan money to a plaintiff) and 2) that it has no existing doctrinal basis.

In respect of reason 1), this problem could of course be overcome with careful drafting. The Committee's view on this issue is addressed in part 5 of this preliminary submission.

In respect of reason 2), the legalisation of litigation funding is only a recent phenomenon, and the boundary lines regarding what kinds of conduct of litigation funders would constitute an abuse of process are still being formulated by the courts.[3] In those circumstances, in the Committee's submission, it was open to the High Court to adopt the interpretation of *Fostif* advocated by Heydon J in *Jeffery & Katauskas*,[4] to the effect that litigation funding without an attendant indemnity for costs orders in favour of the funded plaintiff constituted an abuse of the Court's processes.

In any event, although a lack of doctrinal foundation for a proposition may give the Court a reason not to adopt it, it is not a reason for the legislature not to adopt it. When the *Maintenance, Champerty and Barratry Abolition Act 1993* (NSW)was passed, the parliament did not consider the possibility that it may open the door for litigation funders,

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[3] Cf the difference of opinion in *Fostif* regarding whether the LFA in that case was abusive of process. Callinan & Heydon JJ on the one hand held that it was abusive; Gleeson CJ and Gummow, Hayne and Crennan JJ, on the other hand, held that it was not: *Fostif* (2006) 229 CLR 386, at 407, 436, 488 – 497.

[4] *Jeffery & Katauskas* [2009] HCA 43, especially at [49] – [54].

and therefore did not have a proper policy discussion regarding how litigation funders should be regulated. In the Committee's view, this reference provides an excellent opportunity for New South Wales to ensure that the rules of procedure in the New South Wales justice system help to regulate litigation funders in a way that addresses the particular challenge they represent.

C. Recommendations – making litigation funders underwrite costs orders against funded plaintiffs

Given the problems outlined above, the Committee is of the view that the UCPR should be amended to ensure that, where a funder is involved in litigation, parties awarded costs orders against a funded party receive the entirety of the cost order. Any shortfall between the amount that the funded party has the ability to pay and the total amount of the cost order should be paid by the funder. The Committee recommends two legislative strategies for ensuring this outcome:

amend the UCPR such that the courts have the power to make costs orders against litigation funders; and

amend the UCPR such that such that it requires plaintiffs who are assisted by a litigation funder to provide the court and the defendant with a deed pursuant to which the funder indemnifies the plaintiff against any adverse costs order that may be made against it.

The full implications of these recommendations are discussed below. In the Committee's view, these recommendations could be implemented either individually or together.

(i) Recommendation 1. Giving courts the power to make orders against litigation funders

The Committee submits that the implementation of Recommendation 1 could be accomplished simply by adding a further exception to UCPR 42.3. Rule 42.3 provides that courts do not have the power to make costs orders against non-parties, but provides some exceptions to that general rule. Litigation funders could be added as such an exception.

The Committee is of the view that implementing Recommendation 1 is a necessary feature of the legislature's policy response to the increasing prevalence of litigation funders within civil litigation. Implementing Recommendation 1 would not necessarily place any extra burden on litigation funders, because whether or not costs orders are made against litigation funders in any given case would still be a decision to be exercised by the Court in its discretion. However, it would, as discussed above, provide greater flexibility to the courts in dealing with costs orders, and put in place an incentive on litigation funders to conduct proceedings appropriately where they have some control over the course of the litigation.

Although this measure would not strictly be a change to the rules regarding security for costs orders, this measure, like security for costs orders, is in the Committee's view

designed to protect successful defendants with costs orders in their favour from being out of pocket due to impecunious plaintiffs. Accordingly, it deals with the law and practice 'relating to security for costs and to associated orders' and 'related issues', and comes within the remit of the reference.

The full Recommendation 1 is set out below.

Recommendation 1

That the UCPR be amended such that the court has the power to make costs orders against a litigation funder.

The Committee recommends that rule 42.3 of the UCPR be amended by inserting the following subrule (d1):

"(d1) to make an order for costs against a litigation funder who has provided financial assistance to a party to the proceedings;"

(ii) Mandating indemnities for costs orders made against funded plaintiffs

The Committee submits that the implementation of Recommendation 2 would be a direct method of ensuring that non-funded parties to proceedings can receive the full quantum of their costs orders.

One problem associated with this course would be that extra interlocutory issues may arise to determine whether an indemnity is 'satisfactory'. To counter this, a standard form of indemnity, or a model indemnity clause, could be developed and included in the UCPR.

Although this measure would not strictly be a change to the rules regarding security for costs orders, this measure, like security for costs orders, would in the Committee's view provide defendants with security against the possibility of receiving a costs order against an impecunious plaintiffs. Accordingly, it deals with the law and practice 'relating to security for costs and to associated orders' and 'related issues', and comes within the remit of the reference.

The full Recommendation 2 is set out below.

Recommendation 2

That the UCPR be amended such that it requires plaintiffs who are assisted by a litigation funder to provide the court and the defendant with a deed pursuant to which the funder indemnifies the plaintiff against any adverse costs order that may be made against the plaintiff.

The Committee submits that where proceedings are commenced with the assistance of a litigation funder, the party assisted by a litigation funder should be required to:

inform the Court and the defendants that it is receiving funds from a litigation funder; and

furnish the Court and the other parties to the proceedings with a copy of a document which, to the satisfaction of the Court, provides the funded party with an indemnity from the funder to satisfy any adverse costs order that may be made against the funded party as a result of the proceedings.

If, after reviewing the indemnity, the other parties to the proceedings believe that the indemnity may not be binding, or that it does not satisfactorily indemnify the funded party for adverse costs orders, the other parties to the proceedings should be able to bring a motion to the Court by written notice, in which they seek a stay of proceedings until the funded party furnishes the Court with a satisfactory indemnity.

4. Security for costs orders against individuals supported by litigation funders

A. The current law

The Committee notes that special difficulties arise for defendants seeking security for costs where individuals bring proceedings in their personal capacity but pursuant to an LFA. This is because:

a) the jurisdiction to award security for costs granted by s 1335 of the *Corporations Act 2001* (Cth) does not arise;

b) the jurisdiction to award security for costs pursuant to r 42.21(1) of the UCPR does not arise (and the mere fact that a person other than the plaintiff may benefit from the suit does not bring the scenario within the jurisdiction granted by r 42.21(1)(d));[5] and

c) although the Court has an inherent jurisdiction to make security for costs orders,[6] that jurisdiction is rarely used to make such orders against individuals.

Although the conviction that poverty should be no bar to justice generally protects natural person plaintiffs from security for costs orders,[7] there is no obvious reason why a person who is able to draw on the resources of the litigation funder should be able to resist such an order.

The law in New South Wales, as established in *Green (as liquidator of Arimco Mining Pty Ltd) v CGU Insurance Ltd* (2008) 67 ACSR 105 (**Green**), is that it is within the Court's inherent jurisdiction to make security for costs orders against funders, and that the presence of a funder in litigation should make the Court more ready to exercise its discretion to grant a security for costs order. This finding has been followed in the

[5] See eg *Rugby Union Players Association v Australian Rugby Union Ltd*, Supreme Court of New South Wales, Giles CJ Comm D, 30 July 1997, unreported at [12].
[6] *Rajski v Computer Manufacture & Design Pty Ltd* [1982] 2 NSWLR 443.
[7] *Re Strand Wood Co Ltd* [1904] 2 Ch 1.

Supreme Court of Victoria by Judd J[8] and in the Federal Court by Gilmour J in applying *Green*.[9]

B. The problem – the use of the inherent jurisdiction is not ideal

However, the Committee submits that dealing with these kinds of security for costs disputes within the Court's inherent jurisdiction is less than ideal, for two intertwined reasons. The first is that it is desirable, where possible, to deal with all security for costs within the UCPR mechanism, and use the inherent jurisdiction only in exceptional cases where there is an evident abuse of process.[10] This is the traditional approach.[11] At the very least, this may prove useful for certainty of law.

Secondly, the inherent jurisdiction, at least theoretically, operates slightly differently from the jurisdiction to order that corporations give security under the UCPR and *Corporations Act* jurisdictions. This is because the UCPR jurisdiction is only enlivened where it appears to the Court that there is reason to believe that a corporate plaintiff will be unable to pay the defendant's costs if so ordered,[12] and the *Corporations Act* jurisdiction is only enlivened where it appears by credible testimony that there is reason to believe that that the corporation will be unable to pay the defendant's costs if so ordered.[13] Accordingly, the (at least theoretical)[14] practice of courts appears to generally to treat security for costs applications as a two-stage question: 1) is the jurisdiction enlivened? – the 'threshold question'; and 2) if so, should security be granted? – the 'discretionary question'.[15] No such division arises in the case of the inherent jurisdiction, where the discretion is almost at large, although subject to guidelines.[16]

C. Recommendations – bringing funded individual plaintiffs within the legislative framework

The Committee is of the view that it would be prudent to bring the Court's treatment of natural person plaintiffs,, in the context of security for costs applications, into line with the standard jurisdiction for security for costs. This could be achieved by amending UCPR 42.21 to provide that the Court may order that security be given if an individual plaintiff

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[8] *Bufalo Corp Pty Ltd v Prime Life Corp Ltd* [2009] VSC 171 at [74].
[9] *Gurtler v Finance Now Pty Ltd* [2009] FCA 631 at [11].
[10] See eg *Morris v Hanley* [2000] NSWSC 957; *Bhattacharya v Freedman* [2001] NSWSC 498.
[11] *Green* (2008) 67 ACSR 105 at [45].
[12] UCPR r 42.21(1)(d).
[13] *Corporations Act 2001* (Cth) s 1335(1).
[14] Of course, in practice, the issues of threshold and discretion are often conveniently considered together.
[15] See eg *Beach Petroleum NL v Johnson* (1992) 7 ACSR 203 at 205 (Federal Court), *Livingspring Pty Ltd v Kliger Partners* (2008) 66 ACSR 455 (Supreme Court of Victoria Court of Appeal) at [11] – [12]; *Southern Cross Exploration NL v Fire and All Risks Insruance Co Ltd* (1985) 1 NSWLR 114; *Business Insurance Australia Pty Ltd v District Court of New South Wales* [2006] NSWCA 383; *Belle Monde Pty Ltd v Waterford Holdings Pty Ltd*, Supreme Court of Western Australia, Sanderson M, 22 June 1998, unreported.
[16] *Green* (2008) 67 ACSR 105 at [45].

acting personally is a party to a LFA and there is reason to believe that the plaintiff will be unable to pay the costs of the defendant if so ordered. This amendment would also have the benefit of removing, by implication, the fact that there is an LFA from the class of exceptional circumstances that necessitate the use of the inherent jurisdiction. It seems incongruous (and rather ad hoc) to categorise 'being funded by a litigation funder' alongside abuse of process as an exceptional circumstance.

The full Recommendation 3 is set out below.

Recommendation 3

That the UCPR be amended such that it provides the Court with a statutory jurisdiction to make security for costs orders against individual plaintiffs funded by litigation funders.

The Committee recommends that UCPR rule 42.21 be amended by inserting subrule (f) as follows:

"(f) that a plaintiff, being a natural person, has received financial assistance from a litigation funder for the purposes of conducting the proceedings".

5. Defining litigation funding

Obviously, implementing any of the recommendations in this preliminary submission would require a statutory definition of 'litigation funder' to be added to UCPR. Such a definition of 'litigation funder' must be careful to exclude parties that fund litigation where they had a pre-existing interest in the litigation (such as creditors of plaintiffs who fund their litigation), financial institutions that may fund litigation in the form of a loan, and persons such as family members or other benefactors who fund litigation for personal reasons or on a voluntary basis.

Formulating a precise definition is a delicate task, and the Committee would be interested to consider the suggested definitions of other preliminary submissions to this reference. It may require multiple exposure drafts. For the purposes of providing a suggested starting point, the Committee recommends the following definition of 'litigation funder', to be inserted in the dictionary of the UCPR:

*"**litigation funder** means a person who has provided financial assistance to a party to proceedings in return for a financial benefit to be calculated by reference to the outcome of the proceedings and/or other proceedings, and who does not otherwise have any interest (financial or otherwise) in the proceedings".*

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With thanks to Joanne Chaina and Elias Yamine (editors)