Class actions: When is the lawyer's relationship with the litigation funder too close?

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Introduction

1. Representative or group proceedings (commonly known as 'class actions') are typically lawyer driven. As the costs can be substantial, the costs of such proceedings are increasingly being covered by litigation funders.

2. In two recent cases, the question arose as to whether the proper administration of justice required the Court to restrain the plaintiff's lawyers from continuing to act by reason of their interest in, or connection with, the litigation funder.

3. In *Bolitho v Banksia Securities Limited (No 4)*[1] ("**Bolitho**"), where the plaintiff's solicitor and the wife of senior counsel representing the plaintiff held an indirect substantial interest in the litigation funder and the solicitor was also one of its directors, Ferguson JA of the Victorian Supreme Court held that both the solicitor and senior counsel should be restrained from continuing to act.

4. By contrast, in *Moore v Scenic Tours Pty Ltd*[2] ("**Moore**"), where the litigation funder's director and shareholder was a son of the founder of the solicitor's firm and where most of the shares in the solicitor's firm were owned by a company in which the founder and his wife held equal shares, Garling J of the New South Wales Supreme Court declined to restrain the solicitor on the record and the firm from continuing to act for the plaintiff because the founder of the firm was not in a position to control the legal conduct of the proceedings.

5. This paper briefly considers the Court's inherent jurisdiction to restrain a lawyer from acting in proceedings and the decisions in *Bolitho* and *Moore*.

The test for restraining a lawyer from acting

6. In *Kallinicos v Hunt*,[3] after referring to numerous authorities, Brereton J said that the Court has inherent jurisdiction to restrain a lawyer from acting in a particular matter, as an incident of its inherent jurisdiction over its officers and to control its processes in aid of the administration of justice. His Honour then summarised the relevant principles as follows:

    - The test to be applied in the inherent jurisdiction is whether a fair-minded, reasonably informed member of the public would conclude that the proper

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[1] [2014] VSC 582.
[2] [2015] NSWSC 237.
[3] [2005] NSWSC 1181; (2005) 64 NSWLR 561 at [76]; see also *R & P Gangemi Pty Ltd v D & G Luppino Pty Ltd* [2012] VSC 168.

administration of justice required that a lawyer should be prevented from acting, in the interests of the protection of the integrity of the judicial process and the due administration of justice, including the appearance of justice.

- The jurisdiction is to be considered as exceptional and is to be exercised with caution.

- Due weight should be given to the public interest in a litigant not being deprived of his or her chosen lawyer without due cause.

- The timing of the application may be relevant because the cost, inconvenience or impracticality of requiring a lawyer to cease to act could provide a reason for refusing to grant relief.

Bolitho

Background

7. *Bolitho* involved a group proceeding arising out of the collapse of Banksia Securities Limited. The proceeding was commenced by the representative plaintiff, Mr Bolitho, in the Supreme Court of Victoria in December 2012. In general terms, Mr Bolitho alleged that he and the group members had suffered loss and damage of more than $100 million as a result of the conduct of the various defendants.

8. Mr Bolitho was represented by Mr Norman O'Bryan SC and Mr Mark Elliott, solicitor.

9. The arrangements between Mr Bolitho and Mr Elliott included the following:

   - Mr Elliott would indemnify Mr Bolitho against any costs or liabilities arising out of his role as plaintiff, including any adverse costs order.
   - Mr Elliott would provide his legal services to Mr Bolitho on a 'no win no fee' basis.
   - In the event of a successful outcome (either by judgment in favour of Mr Bolitho and the group members or by a Court approved settlement) Mr Elliott would be entitled to be paid legal fees, including a 25 per cent uplift fee, and disbursements.

10. As a result of most of the defendants indicating that they would be seeking security for their costs, it seems that attempts were made to arrange litigation funding with various established litigation funders. These attempts, however, were not successful. Mr Elliott then "arranged for a group of experienced and financially strong investors to subscribe for $2M of paid up capital in a new public company that has agreed to act as our litigation funder."[4]

11. The new public company was BSL Litigation Partners Limited ("**BSL**"). Mr Elliott's superannuation fund and another company controlled by him held approximately 45

[4] Above, n 1, at [9].

per cent of the shares in BSL. Another 45 per cent of the shares were held by a company controlled by Mr O'Bryan's wife. In addition, Mr Elliott was the secretary and one of three directors of BSL.

12. Under the terms of the litigation funding agreement made between Mr Bolitho and BSL in March 2014, if money was paid to resolve the dispute, BSL would be entitled to be reimbursed for the amounts that it had expended in the litigation and to be paid a fee of up to 30 per cent of the net amount received to resolve the dispute.

13. Given the quantum of the claim, if the claim was successful, the fee payable to BSL might be in the tens of millions of dollars.[5]

14. One of the defendants, with the support of the other defendants, applied for orders restraining Mr Bolitho from continuing to retain Mr O'Bryan and Mr Elliott.

Decision

15. The application was heard by Ferguson JA who proceeded on the basis that if there were grounds to restrain Mr O'Bryan and Mr Elliott from acting, then orders would be made against them and not against Mr Bolitho.[6]

16. Her Honour referred to the test summarised by Brereton J in *Kallinicos v Hunt* and noted that one of the circumstances in which restraint of a lawyer might be justified was where the lawyer had a financial interest in the litigation over and above the legal fees that the lawyer would earn from the litigation. This was because of the risk that the lawyer might not be able to fulfil his or her obligations to the Court by applying an independent and objective mind when conducting the case on behalf of the client.[7]

17. Her Honour accepted that applications to restrain a lawyer from acting had to be viewed with "a degree of circumspection" because the moving parties usually had an "obvious self-interest" in seeking to remove the opponent's lawyers. Nevertheless, her Honour said that if there were good grounds to restrain Mr Bolitho's lawyers from continuing to act, then they remained good grounds regardless of the motivation of the moving parties.[8]

18. Her Honour then considered, first, whether Mr Elliott, and, second, whether Mr O'Bryan, should be restrained from continuing to act and concluded that the fair-minded, reasonably informed member of the public would find that the proper administration of justice required that both Mr Elliott and Mr O'Bryan should be restrained from continuing to act, in the interests of the protection of the integrity of the judicial process and the due administration of justice, including the appearance of justice.

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[5] Above, n 1, at [8].
[6] Above, n 1, at [33].
[7] Above, n 1, at [16]-[19].
[8] Above, n 1, at [47].

Mr Elliott

19. As regards Mr Elliott, her Honour observed that the *Legal Profession Act 2004* (Vic) imposed a 25 per cent limit on the uplift fee that could be charged by solicitors acting on a 'no win no fee' basis and prohibited contingency fees so that a solicitor could not charge as a fee a percentage of the amount obtained by the client from the litigation. Her Honour also observed that the High Court decision in *Clyne v The New South Wales Bar Association*[9] was consistent with the continuing legislative prohibition on contingency fees.[10]

20. Her Honour then said that the reasonable observer was likely to conclude that although the success fee under the litigation funding agreement would not be payable to Mr Elliott in his capacity as a solicitor, nevertheless it was a contingency fee that would benefit him and that, given the size of the interest in the litigation funder, it would be inimical to the appearance of justice to allow the prohibition on contingency fees to be skirted around by this means.[11]

21. Her Honour commented that the position might have been different had Mr Elliott's interest been more modest, but that the 45 per cent interest and the size of the claim took it beyond something that might otherwise have been regarded as insufficiently significant to give rise to concern. Her Honour also indicated that the matter was different from the case where a person who was a lawyer by profession had an interest in the litigation funder but was not the lawyer for the plaintiff in the proceeding that was being funded.[12]

22. In addition, her Honour said that the reasonable observer would form the view that Mr Elliott might be influenced by the substantial financial interest that rested on the outcome of the case and that there was a real risk that he would be, or would be perceived to be, unable to apply the necessary independence required as an officer of the court. Her Honour noted that throughout the course of the proceeding there were likely to be a number of difficult interlocutory applications and, if the matter was not settled, a final hearing, and that how the case was argued and what matters were put to the Court would be important. The reasonable observer would be concerned that there was a sufficient risk that Mr Elliott's (indirect) shareholding in BSL and his position as a director of BSL would give the appearance that his role as a solicitor and officer of the court was compromised, such that this would be detrimental to the integrity of the judicial process. The substantial interest in BSL thus took it beyond the case of the lawyer simply having an interest in protecting payment of his fees.[13]

23. Furthermore, her Honour said that the reasonable observer would also be likely to conclude that Mr Elliott's difficulties were compounded because senior counsel (through his wife) also had a connection with BSL and that this further tarnished the

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[9] [1960] HCA 40; (1960) 104 CLR 186 at [28].
[10] Above, n 1, at [50].
[11] Above, n 1, at [51].
[12] Above, n 1, at [52].
[13] Above, n 1, at [53].

appearance of justice, because there was no senior lawyer representing Mr Bolitho who was independent of BSL.[14]

24. Her Honour found that these considerations weighed more heavily than Mr Bolitho's wish to have Mr Elliott continue as his solicitor and the public interest in not depriving a party of their chosen lawyer. Her Honour also found that the litigation would not be stultified by preventing Mr Elliott from continuing to act because BSL could remain as litigation funder and there was no evidence that a new solicitor could not be found.[15]

Mr O'Bryan

25. As regards Mr O'Bryan, although his involvement in BSL was less than that of Mr Elliott, her Honour said that as a matter of common knowledge, the reasonable observer would know that in most families, what was good or bad financially for one spouse was good or bad for the other spouse. The issue, her Honour said, was not one of gender nor of control of the wife over the husband but whether there was a real risk to the proper administration of justice if Mr O'Bryan were to continue representing Mr Bolitho because of his "family's interest" in BSL.[16]

26. Her Honour found that the reasonable observer would likely conclude that there was a real risk to the proper administration of justice because, if Mr Bolitho's case succeeded or was settled favourably, Mr O'Bryan would indirectly benefit from a contingency fee.[17]

27. Although Mr O'Bryan was not acting on a 'no win no fee' basis, her Honour considered that the significant interest that Mr O'Bryan's family had in BSL had put him in a compromised position such that the reasonable observer would regard the risk that he would or would be perceived to be unable to apply the necessary independence required as an officer of the court, as a real risk.[18]

28. Similarly to what had been said about Mr Elliott, her Honour said that there was no access to justice issue or stultification of the litigation if Mr O'Bryan did not continue to represent Mr Bolitho.[19]

Moore

Background

29. *Moore* involved representative proceedings brought pursuant to Pt 10 of the *Civil Procedure Act 2005* (NSW) by Mr Moore, as representative plaintiff, against Scenic Tours Pty Ltd. The proceedings were commenced in July 2014 in the Supreme Court of New South Wales.

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[14] Above, n 1, at [54].
[15] Above, n 1, at [55].
[16] Above, n 1, at [60]-[61].
[17] Above, n 1, at [61].
[18] Above, n 1, at [62].
[19] Above, n 1, at [63].

30. Mr Moore was represented by Mr Benjamin Hemsworth of Somerville Legal Pty Ltd ("**Somerville Legal**"). However, a Mr Cutri, an employed solicitor, had the day-to-day carriage of the matter.

31. The litigation funder was Legal Justice Pty Ltd ("**Legal Justice**"). Mr Cutri had first attempted to obtain litigation funding from a number of other litigation funders but the evidence did not reveal the outcome of these attempts.[20]

32. Legal Justice had been incorporated in February 2013. Its registered office was that of Somerville Legal. It had a single director, Mr Adrian Somerville ("**Adrian**"), who was also its sole shareholder, holding 100 fully paid $1 ordinary shares in the company.

33. Adrian was a son of Mr Tim Somerville ("**Somerville**") who had originally founded Somerville Legal but was now apparently a consultant to the firm. He was no longer a director of the firm. The directors included another of Somerville's sons, Andrew Somerville, and Mr Hemsworth, the solicitor on the record of the proceedings, who was also managing director.

34. Approximately 84% of the issued share capital in Somerville Legal was owned by a company in which Somerville and his wife held one each of the two shares. Somerville's wife was the sole director and secretary of that company.

35. Somerville and his wife fell within the definition of group members in the pleadings but they were not part of the group. Somerville's name had appeared as a person to be contacted in correspondence seeking the provision of litigation funding and also in correspondence sent to Mr Moore with respect to his becoming the representative plaintiff but there was no evidence that he was ever contacted in relation to this correspondence.

36. Mr Moore had entered into a retainer agreement with Somerville Legal and a litigation funding agreement with Legal Justice.

37. The retainer agreement provided that the costs of the solicitors in relation to the proceedings would be paid by Legal Justice and that Legal Justice had agreed to pay any costs payable to the defendant and to indemnify Mr Moore against the defendant's costs subject to the terms of the litigation funding agreement.

38. The litigation funding agreement, which had been drafted by Mr Cutri, provided, *inter alia*, that upon Mr Moore receiving any of the proceeds of the claim, he was to pay to Legal Justice:

    - his share of the claim's costs and of any defendant costs;
    - 15% of the proceeds of the claim paid or provided by the defendant; and,

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[20] Above, n 2, at [57]-[58].

- 18% of the proceeds of the claim paid or provided by the defendant, on or after 30 November 2014, in addition to the 15%.

39. The litigation funding agreement disclosed that Legal Justice's director and shareholders were relatives of the founding partner of the solicitors, who was also a claimant, and that the solicitors acted on behalf of Legal Justice.

40. Legal Justice's conflict of interest policy identified as a possible conflict of interest that the director and shareholder of Legal Justice was related to Somerville, the founding partner of Somerville Legal, but also stated that:

    - Somerville was not a director, employee or shareholder of Somerville Legal but did provide consultancy services to that firm, and was a beneficiary of a trust which owned shares in Somerville Legal.
    - Somerville had no direct or indirect interest in Legal Justice.
    - Legal Justice had no direct or indirect financial interest in Somerville Legal.
    - These matters did not indicate any conflict of interest in Legal Justice funding litigation conducted by Somerville Legal with or without the personal involvement of Somerville but third parties could perceive a conflict of interest.

41. In November 2014, the defendant's solicitors expressed concern that Legal Justice might not have sufficient capital to meet any adverse costs order

42. In December 2014, Legal Justice deposited $200,000 in a nominated bank account by way of security for costs. The sum of $200,000 was provided by another company, apparently registered in July 2013, the directors of which were Adrian and his brother, Nathan Somerville, another son of Somerville. They were also the shareholders of this company, each owning 50 of the 100 $1 shares which had been issued. The evidence did not reveal the arrangement for the provision of the funds between this company and Legal Justice nor the source of the moneys paid by this company.

43. In February 2015, by notice of motion, the defendant sought orders that Somerville Legal and Mr Hemsworth be restrained from acting for Mr Moore in the proceedings.

Decision

44. The motion was heard by Garling J who dismissed it.

45. His Honour referred to the Court's inherent jurisdiction to restrain a lawyer from acting in a particular case and the principles summarised by Brereton J in *Kallinicos v Hunt*. His Honour also referred to Ferguson JA's decision in *Bolitho*.[21]

46. The defendant had submitted that Adrian, as the son of the ultimate controller and majority owner of Somerville Legal, should be found to have had a substantial

[21] Above, n 2, at [13]-[19].

financial stake in the outcome of the litigation and that, therefore, the Somervilles had a 'family interest' in the litigation similar to that described in *Bolitho* which warranted the restraining of Mr Hemsworth and the firm.[22]

47. Garling J, however, held that the defendant had not shown that there was any direct or indirect financial connection between Somerville Legal and Legal Justice.[23]

48. His Honour said that, in addition, the evidence demonstrated that:

- Somerville, himself, had no role to play as a solicitor for Mr Moore and the group members in the action;
- it was the managing director of the firm, Mr Hemsworth, and Mr Cutri, his employed solicitor, who had the conduct of the proceedings, and they did not take instructions or directions with respect to the conduct of the proceedings from Somerville; and
- Somerville was not a member of the board of directors of the firm.[24]

49. His Honour further said that so long as the existing structure and arrangements for the conduct of the firm remained in place, Somerville was not in a position to control the legal conduct of the proceedings.[25] Accordingly, his Honour concluded that the reasonable observer would not have any concerns about Somerville Legal and Mr Hemsworth continuing to act for Mr Moore.[26]

Alleged "family interest" principle

50. His Honour, however, observed that the defendant's submissions had gone further by suggesting that a distinct principle was to be derived from the decision in *Kallinicos,* as identified by Ferguson JA in *Bolitho*, namely, that where there was a "family interest" in the litigation funder of a solicitor who had the control, or conduct of the funded proceedings, the reasonable observer would reach the requisite degree of concern for the administration of justice, thus justifying the Court making the orders sought.[27]

51. Garling J, however, said that the use of the phrase "family interest" was not of assistance to the defendant because the facts of *Bolitho* were different. In that case, his Honour said, the litigation funder was substantially owned and controlled by the solicitor on the record and the wife of the senior counsel appearing in the proceedings and Ferguson JA had found, correctly with respect to senior counsel, that such was his interest in business enterprises engaged in by his wife that their interest should be treated as being the same for all practical purposes. In addition, as Ferguson JA had pointed out, the success or failure of the proceedings would directly

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[22] Above, n 2, at [59].
[23] Above, n 2, at [68].
[24] Above, n 2, at [69]-[70].
[25] Above, n 2, at [70].
[26] Above, n 2, at [72].
[27] Above, n 2, at [73]-[74].

affect the senior counsel's wife, and thereby indirectly financially affect senior counsel.[28]

52. Given the identity of financial interest and closeness of the relationship in *Bolitho*, Garling J said that it was not surprising that Ferguson JA had concluded that the solicitor and senior counsel should be restrained from continuing to act for the plaintiff and group members in those proceedings.[29]

53. Furthermore, his Honour rejected the suggestion that *Bolitho* had created a new principle of "family interest".[30] His Honour said that:

> "*The conclusion, which the defendant asks this Court to draw, in the absence of evidence to the contrary, is that where there is a family relationship, there will be a direct or indirect financial impact upon every member of the family, from the commercial or professional activities of each of the other family members.*
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> *[87] Here, there is no evidence, but the defendant submits that the reasonable observer would have a perception, of a direct or indirect relationship between the parents, Mr and Mrs Somerville, and their son, Adrian. Other than the coincidence of surname, there is no particular reason for the Court, or a reasonable observer, to draw an inference that the litigation funder is, in fact, being funded and directed, by Mr Tim Somerville.*
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> *[88] … The reasonable observer does not act on suspicion. The reasonable observer does not make connections or draw inferences in the absence of evidence. This is what the defendant seeks to do here.*"[31]

Allegation that the litigation funder was a creation of Somerville

54. His Honour also observed that the defendant had also submitted, in effect, that the reasonable observer would conclude that Legal Justice was the creation of Somerville, established to enable him, a solicitor, to be remunerated by what was, in effect, a contingency fee, when contingency fees were prohibited under the *Legal Profession Act 2004* (NSW).[32]

55. His Honour, however, held that a reasonable observer would not draw this conclusion because, on the evidence available, Mr Hemsworth and Mr Cutri were entirely independent in the way in which they had gone about acting for Mr Moore and the group members and had retained an entirely independent barrister and had apparently acted in accordance with that barrister's advice.[33]

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[28] Above, n 2, at [80]-[84].
[29] Above, n 2, at [85].
[30] Above, n 2, at [80]; [86].
[31] Above, n 2, at [86]-[88].
[32] Above, n 2, at [75];[89].
[33] Above, n 2, at [90]-[91].

56. His Honour acknowledged that Legal Justice was a company without adequate capital to carry on its business but noted that when it was required to provide security for costs, it had done so. His Honour commented that while the lack of adequate capital was an ongoing matter of concern, the defendant was protected by the order for security for costs and, in the event that the sum deposited by way of security for costs proved to be inadequate, could make application for further security.[34]

57. As to the extent that Mr Moore could be said to be at risk by reason of a practically ineffective promise by Legal Justice to indemnify him for legal costs, his Honour said that that was a matter between him, Legal Justice and Somerville Legal.[35]

58. His Honour concluded by saying that this was a jurisdiction which needed to be exercised with caution, and sparingly, and that it was not in the interests of justice, and would not further the administration of justice, for Mr Moore to be deprived of his choice of solicitor.[36]

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[34] Above, n 2, at [92]-[93].
[35] Above, n 2, at [94].
[36] Above, n 2, at [95].