Legal Affairs

Funder IMF in a class of its own

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At a conference hosted by litigation funder IMF (Australia) last month, when University of Sydney professor and class action expert Peter Cashman mentioned competition, he quickly added, “not that anyone could compete with IMF”.

It was a throwaway line, but it is also a sentiment many in the funding industry seem to share.

From small beginnings, IMF has flourished; it is now a powerhouse funder eyeing overseas expansion, is one of the few funders listed on the Australian Securities Exchange and the only one with an Australian financial services licence.

It now funds some of the nation’s biggest class actions – from the big banks fee case to Centro Properties and Aristocrat Leisure.

In the 2010-11 financial year, it pulled in $57.9 million in gross income from cases. Its case portfolio is worth nearly $2 billion.

Hugh McLernon says IMF wants to ensure plaintiffs are protected against rogue traders. **Photo: Megan Lewis**

The federal government has been wrestling for several years with a regulatory response to fit funders.

Many actions would never come to court without them. But there is also potential for abuse where a funder’s financial interest in a case conflicts with the interests of the parties or the court’s objectives.

IMF, which runs about 80 per cent of funded actions in Australia, argues the solution is to require all funders to hold a financial services licence, as it does. Managing director Hugh McLernon says this is not self-interest, but a bid to protect plaintiffs from rogue funders.

“The reality is that if you don’t have the sort of regulation we’re talking about, Bernie Madoff could run litigation funding in Australia from his cell and ASIC [the Australian Securities and Investments Commission] could do nothing about it,” he says. “If it doesn’t need to be licensed, if it’s not regulated, anyone can be in it.”

But some players say IMF is just protecting its market dominance.

“IMF has an agenda, which is generally to monopolise their position in the marketplace and make it harder for everybody else to compete. Their call for licensing or regulation is very self-serving,” says Phoenix Capital Partners director Paul Lindholm, who advises privately held litigation funders, including Singapore-based International Litigation Partners.

Licensing is a sore point for ILP, which lost about $9 million in fees earlier this year when the NSW Court of Appeal ruled that its funding agreement with client Chameleon Mining was a financial product under the Corporations Act, and could therefore be rescinded because ILP didn’t have a licence.

The case, which ILP is appealing in the High Court, is the latest in a string of decisions that have left many in the industry calling for regulatory certainty.

Stop-gap measures exempting funders from licensing and other requirements have been in place since May 2010, while a regulatory response is developed. These have been rolled over every few months to accommodate further delays – the latest until February next year – amid criticism that government indecision has gone on too long.

Michelle Silvers, managing director of rival funder Litigation Lending Services, supports IMF’s position on licensing. LLS plans to have its own licence in the next few months. It is also rejigging internal structures with a view to listing on the ASX in the next year or so.

While regulation should not go so far as to discourage funders, “if regulation is going to protect plaintiffs from unscrupulous funders ... that’s good,” Silvers says.

But Lindholm says the market takes care of itself, through judicial scrutiny, court requirements that funders provide security for legal costs to ensure they can pay if they lose, and the fact that if they don’t perform they’ll go out of business.

“Where is the case of a funder raping and pillaging somebody in the system that regulation would have prevented?” he says. “This is all just fear mongering.”

Lawyer Bruce Dennis, chief executive of LegalFund, agrees there are sufficient laws to ensure funders act ethically and honestly.

“I know that IMF are very keen on there being severe and strict regulation because they love their monopolistic power,” he says.

“I’m not sure what sort of regulations they want to have there – other than as a barrier to entry to stop any other people coming in.”

New to the funding market in 2009, LegalFund hit a stumbling block when it tried to list on the ASX with a prospectus that said it had a track record of success in class actions when it had never run a case that fit the Federal Court’s definition of one.

The issue was rectified and LegalFund raised $5 million, but it was after $6 million “so we canned it”, Dennis says. “We’re not really doing anything at the moment. The minute we tried to raise money, IMF were all over us in terms of nitpicking with ASIC and whinging to my [legal] professional body.”

LegalFund is planning a comeback, but is now considering alternative ways to raise capital such as private investment, he says, adding that IMF’s decision to stop funding claims worth less than $2 million has left a “wide open market”.

O’Neill Partners insolvency lawyer David Purcell, who acts as an intermediary between clients and funders, including IMF, says while IMF does “love to tell the market we’re the only one with [a licence]”, the paucity of competitors is due to a lack of capital.

“IMF does not have any particular exclusivity about their position – it’s just that nobody has yet raised the money to enter the marketplace and compete with them,” he says. The cost of a licence “is negligible in the scheme of things”.

McLernon does not deny the market is hard for new funders, but says the real barriers to entry are the length of cases (long lead times between opening the doors and receiving income, let alone turning a profit), raising the capital to fund actions and employing people with the expertise to pick the right cases.

He puts IMF’s dominance largely down to a lucky first case against British American Tobacco and Phillip Morris “that got us off to a flying start”. But he denies that IMF is a monopoly.

“Someone has to be the biggest in everything and it so happens that we’re the biggest at the moment in Australia,” he says.

Clayton Utz insolvency partner Jennifer Ball says the market is fortunate dominant player IMF is well run and has kept commission (typically 25 to 30 per cent) “at a reasonable commercial rate”.

Freehills class action partner Jason Betts says while licensing may be in IMF’s interests, “if we’re saying we should let our standards down in order to encourage competition, I’m not persuaded by that”.

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