Submission to the Victorian Law Reform Commission Inquiry into Litigation Funding

Contents

Introduction

1. Third party funding of class action litigation by non-class members is relatively new to the Australian legal climate. As such, the law surrounding the funding of such class actions is still underdeveloped and its limitations are still burgeoning.

2. Issues are beginning to be uncovered in older and more historically developed countries with similar legal systems. The United States of America ('US') has undergone extensive overburdening of courts with frivolous, commercially driven class actions with little or no ethical merit. European nations are experiencing a rift in opinions on the class action model. Some nations, such as Switzerland, have condemned such litigation as 'alien to European legal thought'.[1]

3. In addressing these issues, it is suggested that current Australian class action legislation should be reviewed. In reviewing the legislation, additional and alternative models for regulating class action litigation funders are offered.

Scope of this Submission

4. Class actions can crucially provide access to justice for potential litigants and, as such, should not be unduly restricted. However, there is a need to regulate litigation funders in Australia to avoid overburdening the Courts as the US has experienced. Consequently, there is a need to address the growing concerns surrounding the lack of regulatory oversight from legislative and judiciary bodies, the unaddressed conflicts of interest inherent in third-party class litigation, and the unique commercial burdens that arise from class actions.

5. It is suggested in this submission that the Victorian Law Reform Commission consider the following recommendations:

    a. Greater regulatory oversight of litigation funders through the institution of a litigation funder licensing regime which institutes, at the bare minimum, capital adequacy requirements and compulsory security for costs.

    b. Introducing comprehensive disclosure requirements to ensure third-party funders of class actions have adequate strategies to protect group members from improper management of inevitable conflicts of interest, so that the Courts can review the strategies on a discretionary basis.

    c. Greater legislative regulation of litigation funding schemes through introduction of litigation funder agreements to be certified by the presiding court, if it is deemed equitable and conscionable.

[1] Bundesamt für Justiz (Schweiz) [Swiss Federal Bureau for Justice], 'Botschaft zur Schweizerischen Zivilprozessordnung' [Message to Parliament on the Swiss Code of Civil Procedure] (2006) 19(37) *Bundesblatt* [Federal Gazette] 7221, 7290 <https://www.admin.ch/opc/de/federal-gazette/2006/index_37.html> [author's trans].

6. These specifications apply only to class actions with funding from non-class members, otherwise known as third party litigation funders. There are no requirements discussed for class actions that are not funded by these third party litigation funders.

Criticisms of Current Laws

7. Class action litigations were first federally introduced in Australia 25 years ago with the introduction of Part IVA of the *Federal Court Act 1976* (Cth). As of September 2016, 448 class actions have been undertaken.[2] There are currently 14 class action litigations filed with the Victorian Court system, all of which pertain to corporate or commercial interests.[3]

8. Australians are concerned with the entrepreneurial direction class action litigations have taken.[4] One such fear is that resourceful corporations will exploit the virtues of justice by utilising monetary tactics of delay and attrition to 'muscle out' under-equipped class action members. These concerns also feature heavily in academic discourse.[5]

9. Empirical analysis suggests that commercial law firms are significantly more likely to settle class action disputes, resulting in un- or under-supervised negotiations beyond the immediate control of the Courts. This will purportedly increase the likelihood of the exploitation and undercutting of the class member.[6] Conversely, only a quarter of class actions handled without a commercial firms' involvement were settled outside of Court.[7]

10. Ultimately, there has been a concern that Australia is falling into the same commercial pitfalls as the US has regarding class actions.[8] There has been distinct movement in Australia to prevent the adoption of legislation that veers towards enabling 'settlement mills' and needless class actions.[9] US researchers have identified

---

[2] Justice Bernard Murphy, 'Access to Justice under the Part IVA Regime' (Speech delivered at the Class Actions - Current Issues after 25 years of Party IVA seminar, University of New South Wales, 23 March 2017).
[3] As per the Federal Court of Australia Court Registry, as at 16 June 2017, see Federal Court of Australia, *Current Class Actions* (June 2017) Federal Court of Australia <http://www.fedcourt.gov.au/law-and-practice/class-actions/class-actions#vic>.
[4] Justice Bernard Murphy and Camille Cameron, 'Access to Justice and the Evolution of Class Action Litigation in Australia' (2006) 30(2) *Melbourne University Law Review* 399.
[5] See Justice Bernard Murphy and Camille Cameron, 'Access to Justice and the Evolution of Class Action Litigation in Australia' (2006) 30(2) *Melbourne University Law Review* 399; S Stuart Clark and Christina Harris, 'Class actions in Australia: (Still) a work in progress' (2008) 31 *Australian Bar Review* 63; Kevin Lindgren, 'Some Current Practical Issues In Class Litigation' (2009) 32(3) *University of New South Wales Law Journal* 900.
[6] Vince Morabito, 'An Empirical Analysis of Australia's Class Actions Regimes (Report No 2, Australian Research Council, September 2010) 40.
[7] Vince Morabito, 'An Empirical Analysis of Australia's Class Actions Regimes (Report No 1, Australian Research Council, 2009) 4.
[8] Allens><Linklaters, '25 years of class actions: where are we up to and where are we headed?' (Paper, Allens><Linklaters, 27 March 2017) 4.
[9] Dana A Remus and Adam S Zimmerman, 'The Corporate Settlement Mill' (2015) 101(1) *Virginia Law Review* 129.

concerns regarding risks of collusions, disenfranchised plaintiffs, defendants with monopolistic control of negotiations, and premature settlements.[10] Legislation at a federal level has been somewhat proactive in addressing these concerns with US litigation to avoid them being replicated in Australia.[11]

11. Comprehensive analysis is needed to understand and address the risks identified in the US in the context of the potential benefits provided by an increased access to justice. The three key issues discussed in this submission are:

    a. a lack of regulatory oversight;

    b. the inability to manage conflicts of interest; and

    c. the unaddressed commercial burden of litigation funders.

Lack of Regulatory Oversight

12. According to the economic theory of rational choice, there is no need to regulate litigation funders because they will only invest in class actions that have a high chance of success.[12] However, this only works on the assumption that litigation funding takes place in a perfect world. This is not actually the case and this reality has not been reflected in the current regulation of litigation funders.

An Overview of Regulations

13. Litigation funding in Australia was given judicial approval in 2006 in *Campbells Cash and Carry Pty Ltd v Fostif Pty Ltd*.[13] Although now possible in Australia, there were no legislative or judicial guidelines regulating litigation funding, beyond those that governed criminal offences such as fraud.

14. However, in *Brookfield Multiplex Limited v International Litigation Funding Partners Pte Ltd,*[14] the full Federal Court stated that an interest in a funded class action was a managed investment scheme ('MIS')[15] and thus subject to the *Corporations Act 2001* (Cth).[16]

---

[10] Howard M Erichson,'The Problem of Settlement Class Actions' (2014) 82(3) *George Washington Law Review* 951.

[11] S Stuart Clark and Christina Harris, 'Class actions in Australia: (Still) a work in progress' (2008) 31 *Australian Bar Review* 63.

[12]S M Amadae, *Rational Choice Theory* (2 November 2016) Encyclopedia Britannica <https://www.britannica.com/topic/rational-choice-theory>; Australian Securities and Investments Commission (ASIC), 'Litigation Schemes & Proof of Debt Schemes: Managing Conflicts of Interest' (2012) *Consultation Paper 185*.

[13] [2006] HCA 1.

[14] (2009) 260 ALR 643.

[15] A managed investment scheme is a scheme in which a number of people contribute money to be pooled together and invested in a common enterprise, which is managed by a 'responsible entity'. For further information, see Australian Securities and Investments Commission, *What is a managed investment scheme?* (20 October 2014) Australian Securities and Investments Commission <http://asic.gov.au/for-finance-

15. The New South Wales Court of Appeal ruled that litigation funders were required to hold an Australian Financial Services Licence ('AFSL') in order to operate in 2011.[17] This would obligate funders to have capital adequacy, risk management systems, and internal and external dispute resolution procedures for 'retail client' litigants.[18] Litigation funders would also be bound by the *National Consumer Credit Protection Act 2009* (Cth) Schedule 1. This decision was appealed in 2012 in the High Court, who found that litigation funding was not a financial service and did not need AFSLs.[19]

16. The Federal Government then passed *Corporations Amendment Regulation 2012 (No. 6)* (Cth) ('the new regulation'), which superseded another regulation of the same name enacted earlier in the same year. The new regulation exempted litigation funding from the classification of MIS and thus the constraints of the *Corporations Act*.[20] It also maintained *Chameleon*'s position that litigation funders are not required to hold an AFSL.[21] The Court stated that funding arrangements are 'credit facilities', which are not financial products under the *Corporations Act,*[22] even if they may otherwise satisfy the definition of a financial product.[23] The new regulation only obliges litigation funders to have 'adequate' processes in place to manage conflicts of interest.[24]

17. This is the most current Federal regulation in regards to overseeing the litigation funding process; pre-existing consumer protection laws remain applicable. On a state level, Victoria has adopted class action legislation that directly mirrors the federal legislation.

Criticisms of Current Regulations

18. The lack of regulation concerning class action litigation funding has been criticised by the legal profession, especially given the advent of overseas litigation funders entering the Australian market.[25] Although the Federal Government has justified its lack of regulation on the basis that it provides wider access to justice for consumers,

---

professionals/managed-investment-scheme-operators/starting-a-managed-investments-scheme/what-is-a-managed-investment-scheme/>.

[16] *Brookfield Multiplex Limited v International Litigation Funding Partners Pte Ltd* (2009) 260 ALR 643.

[17] *International Litigation Partners Pte Ltd v Chameleon Mining Ltd* [2011] NSWCA 50.

[18] Michael Duffy, 'Two's Company, Three's A Crowd? Regulating Third-Party Litigation Funding, Claimant Protection In The Tripartite Contract, And The Lens Of Theory' (2016) 39(1) *University of New South Wales Law Journal* 180.

[19] *International Litigation Partners Pte Ltd v Chameleon Mining NL* [2012] HCA 45.

[20] *Corporations Act 2001* (Cth).

[21] *International Litigation Partners Pte Ltd v Chameleon Mining NL* [2012] HCA 45.

[22] *Corporations Act 2001* (Cth).

[23] *International Litigation Partners Pte Ltd v Chameleon Mining NL* [2012] HCA 45.

[24] Michael Duffy, 'Two's Company, Three's A Crowd? Regulating Third-Party Litigation Funding, Claimant Protection In The Tripartite Contract, And The Lens Of Theory' (2016) 39(1) *University of New South Wales Law Journal* 165, 181.

[25] Michael Legg, 'Regulations needed for litigation funders who can't pay out when cases fail', *The Conversation* (online), 15 February 2017 <https://theconversation.com/regulations-needed-for-litigation-funders-who-cant-pay-out-when-cases-fail-72502>.

several lawyers have maintained that the lack of regulation leaves litigants open to exploitation by unscrupulous funders.[26]

19. The lack of capital adequacy requirements for litigation funders has been notably critiqued as it is contrary to the Productivity Commission's recommendations in its 2014 Inquiry Report.[27] Capital adequacy requirements provide protection for litigants, ensuring that the litigation funder has sufficient resources to pay for legal fees and potential adverse costs orders.[28] The absence of such an assurance creates the opportunity for poorly resourced litigation funders to attempt to invest in risky class actions for profit, but avoid paying costs orders if their ventures prove unsuccessful.[29] This is exacerbated by funders' ability to limit their liability by basing themselves offshore or operating through subsidiaries.[30]

20. The current protection for both claimants and defendants against such exploitative behaviour by litigation funders is the use of a court order for security for costs, which requires the litigation funder to take steps to make funds available at the start of the litigation process in case of an adverse costs order.[31] However, current practice regarding such orders usually results in a substantially smaller sum being provided than may actually be incurred, leaving the lead claimant of a class action potentially liable for the remaining costs.[32]

21. A recent case involving equine influenza has highlighted the need for better regulations in place that account for losing litigants. In this case, an overseas funder became bankrupt amidst allegations that its parent company was engaging in fraudulent activities.[33] The lead claimant would have had to shoulder a substantial adverse costs order if both parties had not agreed to bear their own costs in a no-compensation settlement.[34]

---

[26] Allens><Linklaters, *Client Update: Regulations Clear the Way for Litigation Funding (Again)* (6 February 2013) Allens><Linklaters <http://www.allens.com.au/pubs/ldr/culdr6feb13.htm?>.
[27] Productivity Commission, *Access to Justice Arrangements*, Report No 75 (2014) 631.
[28] Michael Legg, 'Regulations needed for litigation funders who can't pay out when cases fail', *The Conversation* (online), 15 February 2017 <https://theconversation.com/regulations-needed-for-litigation-funders-who-cant-pay-out-when-cases-fail-72502>.
[29] Michael Legg, 'Regulations needed for litigation funders who can't pay out when cases fail', *The Conversation* (online), 15 February 2017 <https://theconversation.com/regulations-needed-for-litigation-funders-who-cant-pay-out-when-cases-fail-72502>.
[30] Michael Legg, 'Regulations needed for litigation funders who can't pay out when cases fail', *The Conversation* (online), 15 February 2017 <https://theconversation.com/regulations-needed-for-litigation-funders-who-cant-pay-out-when-cases-fail-72502>.
[31] Productivity Commission, *Access to Justice Arrangements*, Report No 75 (2014) 607.
[32] Michael Legg, 'Regulations needed for litigation funders who can't pay out when cases fail', *The Conversation* (online), 15 February 2017 <https://theconversation.com/regulations-needed-for-litigation-funders-who-cant-pay-out-when-cases-fail-72502>.
[33] Ben Butler, 'Equine influenza class action continues', *The Sydney Morning Herald* (online), 1 March 2014 <http://www.smh.com.au/business/equine-influenza-class-action-continues-20140228-33r81.html>.
[34] Marianne Papadakis, 'Maurice Blackburn $11 million out of pocket after failed equine flu class action' *Australian Financial Review* (online) 16 June 2016 <http://www.afr.com/news/maurice-blackburn-11-million-out-of-pocket-after-failed-equine-flu-class-action-20160615-gpjpev>; Michael Legg, 'Regulations needed for litigation funders who can't pay out when cases fail', *The Conversation* (online), 15 February 2017

22. The Productivity Commission further recommended in its report that a licensing regime should be adopted for litigation funders.[35] This would mean that any person or entity can fund litigation in Australia, except the litigants' solicitors due to ethical conflicts.[36] There are no requirements on a litigation funding entity to have any kind of competence nor are there restrictions based on status or background (such as bankruptcy or a previous licence cancellation).[37]

23. Litigants are open to exploitation, given the lack of restrictions on entities seeking to provide litigation funding. This exploitation, due to failure to regulate in the name of access to justice, can result in class action failures. These failures that then make it more difficult for litigants to seek resolutions in courts that are increasingly indifferent to class actions.[38] This in turn can limit access to justice.

24. The main criticisms concerning litigation funding's lack of regulation can be summarised as follows:

    a. There is a lack of capital adequacy requirements for litigation funders;

    b. There are insufficient regulations in place to govern losing class action litigants; and

    c. There is a lack of any kind of licensing regime to regulate who can become a litigation funder.

Conflicts of Interest

25. Conflicts of interest are unavoidable in class actions funded by third parties.[39] However, litigation funders are only required to ensure they have adequate strategies for managing any and all potential conflicts;[40] but this not subject to Court supervision.[41]

26. Litigation funders in Australia were originally required to submit to a certain level of accreditation (see 'Criticisms of Current Laws'). An interest in a funded class action was considered as a financial product for the purposes of Chapter 7 of the *Corporations Act 2010* (Cth).[42] Litigation funders in New South Wales were also required to hold an AFSL.[43] Compulsory AFSLs for litigation funders created

---

<https://theconversation.com/regulations-needed-for-litigation-funders-who-cant-pay-out-when-cases-fail-72502>.

[35] Productivity Commission, *Access to Justice Arrangements*, Report No 75 (2014) 631.

[36] *Legal Profession Uniform Law Australian Solicitors' Conduct Rules 2015* (Vic) r 12.2.

[37] University of New South Wales, *Regulation of Litigation Funding* (2012) University of New South Wales <https://clmr.unsw.edu.au/article//regulation-of-litigation-funding>.

[38] *Paciocco v Australia and New Zealand Banking Group Ltd* (2016) 33 ALR 569.

[39] Australian Securities and Investments Commission, *Litigation Schemes & Proof of Debt Schemes: Managing Conflicts of Interest*, Consultation Paper No 185 (2012) 7.

[40] *Corporations Amendment Regulation 2012 (No. 6)* (Cth).

[41] *Corporations Amendment Regulation 2012 (No. 6)* (Cth).

[42] *Brookfield Multiplex Limited v International Litigation Funding Partners* [2009] FCAC 147.

[43] *International Litigation Partners Pte Ltd v Chameleon Mining NL* [2011] NSWCA 50.

protections for the group members of a class action against the funders' conflicting interests.[44]

27. However, from 13 January 2013, the Commonwealth government exempted litigation funding from the application of the *Corporations Act 2010* (Cth) and any licensing requirements.[45] Litigation funders may enjoy these protections, provided they have adequate arrangements to deal with conflicts of interest.[46] The language that imposes a scheme to 'protect the interests of... members' is overbroad and vague, and fails to adequately address the resolution of conflicting interests in an ethical and impartial manner.[47]

28. Comprehensive schemes mandating the disclosure of conflicts of interest must be installed in order to effectively ensure proceedings involving third-party litigation funders prioritise ethics and are equipped to manage conflicts of interest internally.

Interests at Play

29. Parties will always naturally want serve their own interests in a class action. The nature of a party's involvement in such a dispute will dictate the scope of their interests.[48] In non-class action proceedings, the dichotomy of interests between the plaintiff and the defendant can be easily represented. In class actions however, it can be difficult to form a cohesive claim that best represents all interests involved, as multiple class members can manifest individual as well as group interests.[49] Adding in third parties who do not have a distinct legal interest (i.e. litigation funders) further complicates the already strained balance of interests being represented, and forces acting solicitors to prioritise the representation of certain interests.[50]

30. The duty of the solicitor is to competently and diligently act in the best interests of the client.[51] A solicitor is able to best prioritise its party's interests, if the stakeholders are able to arrive at a particular driving interest (e.g. financial, retributive, resolution-orientated or otherwise) that matches a 'public benefit'.[52] Whilst there may be other interests that influence a stakeholder's (and thereby, its solicitor's) decisions, a larger

---

[44] *International Litigation Partners Pte Ltd v Chameleon Mining NL* [2011] NSWCA 50.
[45] *Corporations Amendment Regulation 2012 (No. 6)* (Cth).
[46] *Corporations Amendment Regulation 2012 (No. 6)* (Cth).
[47] University of New South Wales, *Regulation of Litigation Funding* (2012) University of New South Wales <https://clmr.unsw.edu.au/article//regulation-of-litigation-funding>.
[48] S Stuart Clark and Christina Harris, 'Class actions in Australia: (Still) a work in progress' (2008) 31 *Australian Bar Review* 63, 69.
[49] S Stuart Clark and Christina Harris, 'Class actions in Australia: (Still) a work in progress' (2008) 31 *Australian Bar Review* 63, 68.
[50] Michael Duffy, 'Two's Company, Three's A Crowd? Regulating Third-Party Litigation Funding, Claimant Protection In The Tripartite Contract, And The Lens Of Theory' (2016) 39(1) *University of New South Wales Law Journal* 165, 171.
[51] *Legal Profession Uniform Law Australian Solicitors' Conduct Rules 2015* (Vic) r 4.1.1.
[52] Michael J Legg, 'Shareholder Class Actions In Australia — The Perfect Storm?' (2008) 31(3) *University of New South Wales Law Journal* 669, 707.

or more prominent 'public interest' is necessary to form a cohesive rationale to initiate class action proceedings.[53]

31. Class actions pose a significant issue in managing many members whose drives may be varied, but must be considered to be equally valid.[54] Class members will likely want to seek the most justice-oriented resolution available — a just solution to the perceived injustice suffered by all class members.[55] Some class members, however, may seek to impose more punitive action in an effort to create justice, over traditional monetary compensation.[56] In pursuing these interests, concerns such as attritional factors and related costs are likely more prominent concerns for class members as they may be to a third party litigation funder.[57] Ultimately, although a class may seek the best settlement that offers justice and compensation for wrongs endured by the group, it can be difficult for all group members to understand the full implications of a settlement offer.[58]

32. As a purely financially-driven party, litigation funders comparatively perceive the 'best settlement' as one with the greatest return and the least expense.[59] In seeking to achieve this goal, a litigation funder will be more inclined to aggressively seek return on investment over legal justice.[60] The nature of these commercial interests can result in striving for awards that have greater commercial benefit with the sacrifice of integrity, as the dignity lost is not necessarily their own but the class members'.[61] Litigation funders are more inclined to settle out of court if the settlement offer exceeds the perceived commercial award of the court; this does not always guarantee a conclusion in the best interest of the class members.[62] Inclination for settlement can be increased if the litigation funders perceives the expenses (eg Court costs, solicitor's fees, etc.) to be approaching their maximum limit of expenses budgeted for; similarly,

---

[53] Michael J Legg, 'Shareholder Class Actions In Australia — The Perfect Storm?' (2008) 31(3) *University of New South Wales Law Journal* 669, 707-708.
[54] Justice Bernard Murphy and Camille Cameron, 'Access to Justice and the Evolution of Class Action Litigation in Australia' (2006) 30(2) *Melbourne University Law Review* 399, 415.
[55] *O'Sullivan v Challenger Managed Investments Ltd* (2007) 214 FLR 1.
[56] Michael J Legg, 'Shareholder Class Actions In Australia — The Perfect Storm?' (2008) 31(3) *University of New South Wales Law Journal* 669, 709.
[57] Justice Bernard Murphy and Camille Cameron, 'Access to Justice and the Evolution of Class Action Litigation in Australia' (2006) 30(2) *Melbourne University Law Review* 399, 408.
[58] Australian Securities and Investments Commission, *Litigation Schemes & Proof of Debt Schemes: Managing Conflicts of Interest*, Consultation Paper No 185 (2012) 7; Justice Bernard Murphy and Camille Cameron, 'Access to Justice and the Evolution of Class Action Litigation in Australia' (2006) 30(2) *Melbourne University Law Review* 399, 415.
[59] Australian Securities and Investments Commission, *Litigation Schemes & Proof of Debt Schemes: Managing Conflicts of Interest*, Consultation Paper No 185 (2012) 7.
[60] S Stuart Clark and Christina Harris, 'Class actions in Australia: (Still) a work in progress' (2008) 31 *Australian Bar Review* 63, 91.
[61] Australian Securities and Investments Commission, *Litigation Schemes & Proof of Debt Schemes: Managing Conflicts of Interest*, Consultation Paper No 185 (2012) 9.
[62] S Stuart Clark and Christina Harris, 'Class actions in Australia: (Still) a work in progress' (2008) 31 *Australian Bar Review* 63, 91.

if they perceive the proceedings to be 'drawn out', litigation funders are inclined to settle.[63]

33. As instructed by the *Legal Profession Act 2004* (Vic) Ch 3, solicitors are charged with representing, to the best of their ability, their client's interests in a manner that is transparent and ethically upstanding. However, it would be imprudent to suggest that solicitors are completely unbound by personal interest; representatives expect fair monetary compensation for their service, in the form of legal fees.[64] Solicitors' concerns as to what forms the 'best settlement' and what constitutes unbounded resource consumption vary depending on the interests of the client.[65] In third-party litigation such as that of class actions, it can be difficult for the solicitor to discern whether the interests of the class members or the litigation funders should be given greater attention, and more difficult still to determine which is to be prioritised over the other.[66]

34. It is easy to see how prioritising a certain interest can fuel conflict and drastically alter the course of the proceedings. As such, it is paramount to recognise that an acting solicitor's decision to prioritise a particular party's interest is crucial, and instructing solicitors in a manner that is ethical is integral to resolving these quandaries.[67]

35. It is suggested that the most responsible course of action for solicitors to take in these circumstances, is to favour the interests of the class members as the initial and primary client for the proceedings. Whilst the interests of the litigation funders as secondary clients can be considered, they should only do so in a manner which serves to temper difficult decisions, and should not directly conflict with or compromise the interests of the class members.[68] For example, regarding arduous and 'drawn out' proceedings, if it is in the interests of the class members to proceed to its conclusion, then the solicitor should be able to serve these interests.[69] This decision should be tempered with tighter restrictions on resource consumption and expenses to acknowledge and loosely acquiesce to the interests of the litigation funders.[70]

36. Finally, more obvious conflicts for litigation funders, such as competitive advantages arising from investment in a class action, or industry control resulting from the

---

[63] S Stuart Clark and Christina Harris, 'Class actions in Australia: (Still) a work in progress' (2008) 31 *Australian Bar Review* 63, 91.
[64] Australian Securities and Investments Commission, *Litigation Schemes & Proof of Debt Schemes: Managing Conflicts of Interest*, Consultation Paper No 185 (2012) 7.
[65] *Legal Profession Uniform Law Australian Solicitors' Conduct Rules 2015* (Vic) r 4.
[66] Australian Securities and Investments Commission, *Litigation Schemes & Proof of Debt Schemes: Managing Conflicts of Interest*, Consultation Paper No 185 (2012) 8.
[67] *Legal Profession Uniform Law Australian Solicitors' Conduct Rules 2015* (Vic) r 2.
[68] Australian Securities and Investments Commission, *Litigation Schemes & Proof of Debt Schemes: Managing Conflicts of Interest*, Consultation Paper No 185 (2012) 20.
[69] Justice Bernard Murphy and Camille Cameron, 'Access to Justice and the Evolution of Class Action Litigation in Australia' (2006) 30 (2) *Melbourne University Law Review* 399, 408.
[70] Australian Securities and Investments Commission, *Litigation Schemes & Proof of Debt Schemes: Managing Conflicts of Interest*, Consultation Paper No 185 (2012) 24.

outcome of a class action proceeding, should be dealt with in accordance to the interpretations of the *Competition and Consumer Act 2010* (Cth).[71] It need not be said that any relationships (financial, competitive, subsidiary or otherwise) between acting solicitors, litigation funders and class members should be viewed with scrutiny. Any relationship that would reasonably be expected to result in undue influence or benefit for either party should be viewed as professional,[72] corporate,[73] or individual misconduct respectively.[74]

Introduction of Protective Arrangements

37. A balance needs to be struck between the facilitation of an applicant-group's access to justice and the fear of 'entrepreneurial' litigation. Litigation funding necessarily requires tripartite cooperation between the litigation funders, the group members, and the group's lawyers.[75] As a result, the Australian Securities and Investment Commission ('ASIC') recognised that conflicts of interest will undoubtedly occur with litigation funders,[76] and thus, there is a requirement that litigation funders at least have 'arrangements' to protect the interests of class action group members.[77]

38. However, these required arrangements are only required to be managed internally and have little to no oversight from an independent body.[78] Australian class action procedure does not currently require certification that internally-managed arrangements are wholesome and ethical, nor is there any requirement that arrangements be approved by an independent Court.[79] The inclusion of a certification requirement was deliberately not included in Australian class action procedure for economical reasons; those reasons did not necessarily ensure adequate and fair management of conflicts of interest.[80]

39. To ensure fairness in class actions resolved through settlements, Australian courts have tended to apply the standard of 'fairness' developed in the US to determine a settlement's acceptability among all group members.[81] However, the Courts have not unanimously adopted the US test.[82] As such, there is no universal measure for

---

[71] *Competition and Consumer Act 2010* (Cth).
[72] *Legal Profession Act 2004* (Vic) ch 4.
[73] *Corporations Act 2001* (Cth) ch 7.
[74] *Crimes Act 1958* (Vic) pt I div 2.
[75] Michael Duffy, 'Two's Company, Three's A Crowd? Regulating Third-Party Litigation Funding, Claimant Protection In The Tripartite Contract, And The Lens Of Theory' (2016) 39(1) *University of New South Wales Law Journal* 165.
[76] Australian Securities and Investments Commission, *Litigation Schemes & Proof of Debt Schemes: Managing Conflicts of Interest*, Consultation Paper No 185 (2012) 8 [16].
[77] *Corporations Amendment Regulation 2012* (No. 6).
[78] *Corporations Amendment Regulation 2012* (No. 6).
[79] S Stuart Clark and Christina Harris, 'Class actions in Australia: (Still) a work in progress' (2008) 31 *Australian Bar Review* 63.
[80] Law Reform Commission, *Group Proceedings in the Federal Court*, Report No 46 (1988) 63.
[81] See Fed. R. Civ. P. 23(e); S Stuart Clark and Christina Harris, 'Class actions in Australia: (Still) a work in progress' (2008) 31 *Australian Bar Review* 63.
[82] *Darwalla Milling Co Pty Ltd v F Hoffman-La Roche Ltd (No 2)* (2006) 236 ALR 322, [32]-[39].

litigation funders to have any form of arrangement to protect the interests of class action group members with regard to settlement agreements.

40. It is understood that there will never be a universal set of conflicts in each litigation-funded class action. Thus, it will be virtually impossible to create a set 'arrangement' for dealing with every and all conflicts that may emerge. Full and frank disclosure of any and all conflicts that may emerge would assist in ensuring all parties are suitably protected against the mismanagement of such conflicts.[83] Minimal but necessary Court oversight would also ensure that no immediate conflicting interest are permitted to impact on proceedings.[84]

41. It is recommended that any 'arrangement' to protect the interests of class action group members should include the free and full disclosure of any potential conflicts that may arise.[85] Acting solicitors are duty-bound to exercise discretion in managing these conflicts, upon the foundation that the primary stakeholders are the class action members. Courts should be asked to approve litigation-funding agreements between litigation funders and group members on discretion if they are conscionable and ethically upstanding. The proposed solution of certification requirement regulations for litigation funders is addressed below in the recommendations.

Commercial Burden of Litigation Funders

42. A significant issue in class action litigations is the equitable divide of an award between acting solicitors, the manifested class members, and the generous litigation funders. There is a need to share the awards in a manner that neither disadvantages all parties nor inequitably advantages any single party. It is suggested that comprehensive legislation will assist in regulating the divisions of awards, but careful thought must be applied to address the aforementioned conflicts of interest in a regulatory manner.

43. If litigation funders are rewarded at the expense of the class members, the action (and future actions) are likely to fall victim to the phenomena of corporate settlement mills and class litigation mills. Such mills are a commercialisation of litigation in the courts system seeking to push through heavily funded, but ultimately insubstantial class actions for the sake of turnover.[86] These high-resource-consuming burdens trivialise the original purpose of the class action: to enable numerous individuals to

[83] Australian Securities and Investments Commission, *Litigation Schemes & Proof of Debt Schemes: Managing Conflicts of Interest*, Consultation Paper No 185 (2012) 12 [26].
[84] Australian Securities and Investments Commission, *Litigation Schemes & Proof of Debt Schemes: Managing Conflicts of Interest*, Consultation Paper No 185 (2012) 12 [26].
[85] Kevin Lindgren, 'Some Current Practical Issues In Class Litigation' (2009) 32(3) *University of New South Wales Law Journal* 900; Australian Securities and Investments Commission, *Litigation Schemes & Proof of Debt Schemes: Managing Conflicts of Interest*, Consultation Paper No 185 (2012) 12 [26].
[86] Dana A Remus and Adam S Zimmerman, 'The Corporate Settlement Mill' (2015) 101(1) Virginia Law Review 129.

address grievances against large, highly resourceful corporations in the pursuit of justice, where otherwise an independent individual would have been disadvantaged.[87]

44. Conversely, if litigation funders are under-incentivised, crucial and meritorious class actions may fail to follow through to trial due to lack of resources and support. For litigation funders, for whom the risks imposed by an anti-funding system outweigh the perceived benefit, the most financially sensible option is to deny support to class action members.[88] This is especially so considering that such funders rely almost solely on the return-on-investment to justify supporting a class action.

45. Similarly, class actions may cease to be considered as a viable option if litigation funders are obstructed from the industry altogether. Where there is no financial reward, there is no financial support from a party that relies entirely on the financial return, rather than the legal return, of an action. There is a perilous lack of support for independent, largely unfinanced class actions, who must meet the standards of heavily-funded and resource-equipped organisations.[89] It is broadly accepted that, where litigation becomes a game of 'outlasting' one's opponents, resource-heavy corporations have the advantage and justice is far harder won.

46. Equilibrium must be struck that addresses the realistic need for funding that class actions require. If this cannot be achieved through government-based funding programs and grants,[90] then the economic demand will be addressed by litigation funders.[91]

47. However, an unbridled financially-driven party playing bank for a resource-poor, legally-motivated class is guaranteed to develop significant barriers to justice.[92] Commercially-based interests of independent, unregulated parties are likely to be under-monitored and fall victim to a lack of court intervention.[93] By extension, such lack of oversight will foster conflicts of interest between class members seeking justice and financially-motivated investors that ethical lawyers are under-equipped to navigate.[94] Whilst the influence of the Court should be minimal and merely advisory

---

[87] Justice Bernard Murphy, 'The Operation of the Australian Class Action Regime' (Paper presented at Bar Association of Queensland — The changing face of practitioners conference, Sheraton Mirage, Gold Coast, 8 March 2013).

[88] Tyler W Hill, 'Financing the Class: Strengthening the Class Action Through Third Party Investment' (2015) 125 *Yale Law Journal* 484.

[89] Martin H Redish, 'Rethinking The Theory Of The Class Action: The Risks And Rewards Of Capitalistic Socialism In The Litigation Process' (2014) 64 *Emory Law Journal* 451.

[90] S Stuart Clark and Christina Harris, 'Class actions in Australia: (Still) a work in progress' (2008) 31 *Australian Bar Review* 63.

[91] Martin H Redish, 'Rethinking The Theory Of The Class Action: The Risks And Rewards Of Capitalistic Socialism In The Litigation Process' (2014) 64 *Emory Law Journal* 451.

[92] Jonathan R Macey and Geoffrey P Miller, 'The Plaintiffs' Attorney's Role in Class Action and Derivative Litigation: Economic Analysis and Recommendations for Reform' (1991) 58(1) *University of Chicago Law Review* 1.

[93] Christopher R Leslie, 'The Significance Of Silence: Collective Action Problems And Class Action Settlements' (2007) 59 *Florida Law Review* 71.

[94] Jonathan R Macey and Geoffrey P Miller, 'The Plaintiffs' Attorney's Role in Class Action and Derivative Litigation: Economic Analysis and Recommendations for Reform' (1991) 58(1) *University of Chicago Law Review* 1.

in overseeing these matters, there is a distinct need to properly manage conflicts, particularly where each party is driven by separate and yet intertwined interests.

Recommended Changes to Current Regime

48. It is recommended that safeguards be put in place to govern third-party funding of class actions. This would ensure that class members' ability to access justice is adequately protected from both legislative smothering and unscrupulous funders. These safeguards should be stronger and more strenuous than a responsibility to have 'adequate' processes in place to avoid conflicts of interest.

Expanded Regulatory Oversight

49. The first recommended safeguard is the institution of a capital adequacy requirement for third-party entities seeking to fund class actions. The most simplistic solution would be to introduce a regulation that would set a minimum capital requirement for litigation funders. A proportional capital adequacy requirement could prove to be an adequate alternative, whereby litigation funders would be required to show they have capital proportional to the amount at stake in a given class action.

50. However, a proportional approach may be difficult to establish. This is especially so when considering that the purpose of capital requirements are to address concerns that funders may not be able to pay adverse costs, which are difficult to calculate at the beginning of a lawsuit.

51. Instead of the capital adequacy requirements, a regulation could be introduced to require litigation funders to provide security for costs at the beginning of class action proceedings. This would protect the lead claimant from any potential adverse costs, whilst also ensuring that any such costs would be paid.

52. Both of the above recommendations — the capital adequacy requirements and compulsory security for costs — could be established as part of a larger licensing regime. Both legal professionals and the Productivity Commission have recommended such a licensing regime.[95]

53. A licensing regime for litigation funders in Victoria could be adopted based on the same basic model as used in the United Kingdom ('UK'). Litigation funding has been adopted in the UK,[96] but litigation funders are only expected to be self-regulating, using *A Code of Conduct for Litigation Funders* as a guideline ('the Code').

---

[95] University of New South Wales, *Regulation of Litigation Funding* (2012) University of New South Wales <https://clmr.unsw.edu.au/article//regulation-of-litigation-funding>; Productivity Commission, *Access to Justice Arrangements*, Report No 75 (2014) 631; Michael J Legg, 'Shareholder Class Actions In Australia — The Perfect Storm?' (2008) 31(3) *University of New South Wales Law Journal* 669, 710.

[96] *Legal Aid, Sentencing and Punishment of Offenders Act 2012* (UK) 61 Eliz 2, c 10, pt 2.

54. The Code outlines the standards of practice expected by funders who are members of the Association of Litigation Funders of England and Wales. Although it is a self-elected choice to observe the Code, it is hoped that potential class members will be more likely to seek funds from observing entities because the observing entities have a prescribed standard of conduct.[97]

55. The Code includes structures for litigation funders including declining to influence solicitors or barristers to cede control of the dispute to the funder, maintenance of adequate financial resources, and dispute resolution processes. It is clear that the UK model is much more comprehensive when compared to current Australian regulations. If future regulations are to be adopted using the Code as a guide, it is recommended that requirements be mandatory as opposed to voluntary.

56. Regarding the necessary expansion of regulatory oversight, two crucial recommendations have been made. Firstly, regulations should introduce some form of capital adequacy requirement. Regulations should also be introduced to require third party litigation funders to provide security for costs at the beginning of any class action proceeding.

Strategies for Managing Conflicts

57. Numerous methods have been suggested to attempt to effectively regulate the unavoidable conflicts of interest that arise in third-party funded class actions. In recognition of the lack of regulation governing such unavoidable conflicts, ASIC has suggested it intends to remove other exemptions from the *Corporations Act* previously accorded to litigation funders.[98] ASIC did not, however, suggest a regulatory system be adopted to mandate the disclosure of and systems to deal with conflicts of interest; its recommendations centred around litigation funders internally reviewing their relevant strategies.[99]

58. Alternatively, the Council of Chief Justices of Australia and New Zealand have suggested several rules be legislatively adopted to regulate litigation funders' management of conflicts of interest.[100] The Council's recommendations effectively provide for the certification of a litigation funders' arrangement to deal with potential conflicts of interest; they suggest the litigation funding agreement between the funder and the group members be submitted to the Court.[101] This system would ensure that the rights of group members are protected from potential abuse by overly entrepreneurial litigants who do not wish to internally review their strategies.

---

[97] Productivity Commission, *Access to Justice Arrangements*, Report No 75 (2014) 631.
[98] Australian Securities and Investments Commission, *Litigation Schemes & Proof of Debt Schemes: Managing Conflicts of Interest*, Consultation Paper No 185 (2012) 13 [29].
[99] Australian Securities and Investments Commission, *Litigation Schemes & Proof of Debt Schemes: Managing Conflicts of Interest*, Consultation Paper No 185 (2012) 13 [29].
[100] Kevin Lindgren, 'Some Current Practical Issues In Class Litigation' (2009) 32(3) *University of New South Wales Law Journal* 900.
[101] Kevin Lindgren, 'Some Current Practical Issues In Class Litigation' (2009) 32(3) *University of New South Wales Law Journal* 900.

59. Courts should be allowed to use their discretion when considering the 'adequacy' of strategies in a funding agreement based on equitable principles of conscionability. Industry standards for the acceptable management of conflicts of interest can assist in determining whether a funding agreement adequately protects the interests of all parties. The aim of the Court should not be to bar potential funders on the grounds that their interests may differ from that of the class as this is inevitable. Rather, the Court's role should be solely to determine whether strategies exist that would actually be 'adequate' in managing any issue caused by a conflict of interest.

60. It is to be expected that any relation between a litigation funder and a defendant is to be viewed with utmost scrutiny — whether the litigation funder is a competitor, or an associate seeking to "hedge their bets". Provisions should specify that litigation funders cannot be in direct competition with the defendant, or — similar to the interpretations of the *Competition and Consumer Act 2010* (Cth) — should prohibit collusion between defendants and litigation funders who stand to directly benefit from the abuse of a class action.[102]

61. Entrepreneurial litigation funders are not necessarily always going to unethically enforce interests that conflict with group members, but it must be recognised that litigation funders, by their nature, are inherently financially motivated. Litigation funders approach class actions as purely financial investments. Therefore, they should be required to maintain arms length dealings with all parties involved. As such, penalties should apply for litigation funders who are too heavily involved with acting solicitors, or who attempt to direct the proceedings to favour themselves.

62. As their interest is purely financial, their involvement should only be relevant at the commencement of proceedings to register their interest and at their conclusion, to collect upon their equity. At no point should litigation funders be involved in the legal matters at hand.

63. An alternate strategy to ensure conflicts of interest are properly managed would be to repeal the *Corporations Amendment Regulation 2012 (No. 6)* (Cth). As mentioned, litigation funders were previously required to hold an AFSL and abide by Chapter 7 of the *Corporations Act 2001* (Cth). The removal of these requirements by the *Corporations Amendment Regulation 2012 (No. 6)* removed the protections they afforded to class action group members. This is why ASIC suggested removing the other exemptions from the *Corporations Act 2001* (Cth) it had previously provided litigation funders. As such, the reintroduction of those requirements would suitably raise the standard placed on litigation funders to manage conflicts of interest.

64. In summary, two main recommendations have been made concerning the management of potential problems posed by inevitable conflicts of interest in third-party funded class actions. It was firstly recommended that litigation funding agreements be discretionarily certified by the Courts prior to the commencement of a class action proceeding. This would ensure 'adequate' strategies are actually in place

[102] *Competition and Consumer Act 2010* (Cth).

to manage conflicts as they arise. Alternatively, it was recommended that the exemptions from the *Corporations Act 2001* (Cth) for litigation funders be removed.

Regulation of Litigation Funding Schemes

65. Direct and unambiguous legislative framework should be introduced to regulate litigation funders registering interest in class action investment, in order to lessen the potential for inequitable and unconscionable class action litigation. Encompassed in these regulations must be specifications as to when class actions are available to be funded, which litigation funders are able to register interest, and how litigations funders can register that interest.

66. Agreement for certification should be prepared and submitted by the applicant's representative to the Court at the initial hearing. This agreement should provide details of all litigation funders, and the percentage of equity they hold in the investment fund pool for the class action. All litigation funders are entitled to access information regarding their equitable share in the investment fund, as well as a summarised prospectus of the case to be brought; the acting solicitor is required to prepare this documents and submit them as part of the disclosure documents. All monies of the investment fund should be held in trust by the acting solicitor, who will in turn distribute the funds as per the certified agreement at the conclusion of the action.

67. To ensure expeditious court filings, hearings and proceedings, legislation must specify within what timely bounds litigation funders may register their interest to invest in a class action. Such time expires upon filing of the certification agreement, which marks the initial Court consultancy as to the equitability of the certification. A reasonable amount of time should precede this filing date, in which litigation funders can register interest, organise funds and submit investment. Typical court timeframes suggest fourteen days would be the favourable time; however, it is recommended that registration should remain open for approximately three months to balance expeditious proceedings and opportunity to organise an organisations' monetary affairs. The beginning of this period is marked by the initial court filing, but before certification agreement filing.

68. Interest should be registered directly with the acting solicitor for the applicant, with relevant company details recorded alongside the litigation funder's investment equity. The interest is realised as equity upon receipt of the funds into the class action investment trust, as monitored by the acting solicitor.

69. Legislation should specify without exclusion the requirements for litigation funders who are able to register their interests. Aside from aforementioned conflict of interest prohibitions, legislation should require that litigation funders be registered businesses (Australian or otherwise) or Australian citizens (for the purposes of taxation).

70. Legislation should provide for a requirement that litigation funders demonstrate capital adequacy in order to be approved at certification. Relevant financial reports and bank statements detailing litigation funders' capital should be submitted as disclosure documents upon application for agreement certification. In addressing aforementioned concerns from the United Kingdom regarding licensing of litigation funders, the Court will grant a limited license to litigation funders for the duration for their investment upon certification and approval of the filed agreement. Where a litigation funder is rejected on the grounds of inadequate capital, their investment sum is to be returned in full and their equity in the class action dissolved.

71. It is the acting solicitor's responsibility to prepare the certification agreement and register all interest for the class action investment fund, as well as to hold all funds in trust.

72. The Court's role in regulating certification agreements and interpreting the applicable legislation should be discretionary within reasonable guidelines. Agreements should be certified on the understanding that they are equitable and conscionable, adhere to reasonable suggestions for division of award funds, and provide contingencies for unsuccessful litigation.

Regulation for Division of Funds

73. Legislation should provide broad and general, but specific guidelines for equitable divisions of awards. Framework should be provided that limits the power of all parties, and acting judges, to unconscionably divide the awards in favour of one party. For example, after legal fees are deducted from the award fee, class members should collectively be entitled to no less than 35 per cent of the share of the remaining sum. What remains of the award fee after these deductions is distributed according to investor equity, as certified in a court order at the lodging of the proceedings.

74. Where expenditure is less than expected, any remaining funds of the investment pool retained after expenditure should be returned to the fund and distributed alongside the award fee as set out in the certification agreement.[103]

75. Where expenditure is more than expected, to the extent that the available fund is consumed, the acting solicitor may approach the Court for approval to open a secondary registration of interest in order to raise capital.[104] Such an application should be undertaken with heavy scrutiny into the expenditures of the primary fund, with the Court only approving this extension for a secondary fund if it deems the class action to still be meritorious. In such a circumstance where this extension is approved, a secondary registration period is opened to accept registrations of interest

[103] Tyler W Hill, 'Financing the Class: Strengthening the Class Action Through Third Party Investment' (2015) 125 *Yale Law Journal* 484.
[104] Tyler W Hill, 'Financing the Class: Strengthening the Class Action Through Third Party Investment' (2015) 125 *Yale Law Journal* 484.

from secondary litigation funders, as well as increases of capital from primary litigation funders.[105] Equity, as determined on a percentage basis, is adjusted to reflect the additional investments. Where the Court denies an extension, it is recommended to the acting solicitor that the defendant be approached to settle the action as a final effort. The Court will approve the settlement in adhering to the original certified agreement.

76. Where litigation is unsuccessful, the certification agreement should provide contingencies to address return of investment funds. Legal fees should be deducted as an expenditure from the investment fund, and the remaining sum redistributed to the litigation funders according to their respective equity. The loss on investment is understood to be an accepted risk of the litigation funder acknowledged upon registration of interest, and the lost investment is considered to be surrendered. No funds are distributed to any class members, as it is understood that the Court has deemed their interest unrealisable or dismissible.

Summary of Recommendations

77. Class actions are a crucial element in Australia's judicial system to allow groups of aggrieved people to have access to justice. However, given the commercial nature of class actions in Australia, third party litigation funders are required to ensure these groups can actually sustain costly class action procedures. Despite their beneficial contribution, litigation funders need to be regulated to ensure they do not abuse the class action process.

78. Changes to current regulations are required to ensure class action groups' access to justice is not impeded, but entrepreneurial litigation funders are not discouraged. With respect to the necessary expansion of regulatory oversight, the following recommendations were made:

    a. The introduction of a capital adequacy requirement.

    b. Require litigation funders to provide security for costs at the commencement of proceedings.

79. The following recommendations were suggested to implement a strategy to manage the unavoidable conflicts of interest in class actions funded by third parties:

    a. Require a copy of their funding agreement between the litigation funders and the group members be provided to the Court as a form of certification.

    b. Remove exemptions from the *Corporations Act 2001* (Cth) currently afforded to litigation funders.

[105] Tyler W Hill, 'Financing the Class: Strengthening the Class Action Through Third Party Investment' (2015) 125 *Yale Law Journal* 484.

80. Additionally, the following recommendations were suggested to regulate litigation funding schemes:

    a. There should be several requirements for litigation funders to satisfy in order to register their interests in litigations they wish to fund.

    b. The requirements should ensure litigation funders adhere to a wide array of equitable requirements regarding both commitment to funding and not being able to abuse potential outcomes of the litigation.

81. Further regulations should provide for broad, but specific guidelines for the equitable division of awards as well as ensuring class actions concluded via settlement or alternative dispute resolution are still subject to the requirements of the certified agreements as ordered by the Courts. These measures should ensure, the interests of all parties involved in third party funded class actions are adequately preserved.