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Helen Fatouros
Commissioner
Victorian Law Reform Commission
Level 3, 333 Queen Street
MELBOURNE VIC 3000

via email: law.reform@lawreform.vic.gov.au

Dear Ms Fatouros

Litigation funding and group proceedings

Thank you for the opportunity to provide a submission to the Victorian Law Reform Commission's (**VLRC**) consultation paper titled *'Access to Justice – Litigation Funding and Group Proceedings'* (**Consultation Paper**).

The Australian Institute of Company Directors (**AICD**) is committed to excellence in governance. We make a positive impact on society and the economy through governance education, director development and advocacy. Our membership of more than 40,000 includes directors and senior leaders from business, government and the not-for-profit sectors.

We welcome the VLRC's inquiry into litigation funding and group proceedings, and the insightful and comprehensive Consultation Paper.

The AICD acknowledges the role that class actions play in supporting access to justice, and the support that litigation funders provide in facilitating class actions. However, we have long advocated for regulation and supervision of litigation funders. Given the role of litigation funders in instigating, funding and directing civil litigation, it is essential that appropriate checks and balances are in place in order to safeguard the integrity of not only Victoria's justice system, but that of all jurisdictions. In our view, the continued absence of meaningful supervision and regulation of litigation funders is not in the best interest of the community or the economy.

1. Summary

In summary, the comments of the AICD are as follows:

(a) Third party litigation funders should be subject to an appropriate form of nationally consistent regulatory oversight. The AICD believes the best way to achieve this outcome is through federal legislation with effective oversight by an appropriate supervisorial body.

(b) However, given the continued absence of federal regulation, litigation funders continue to operate in a largely unregulated environment, a situation that must not continue. As a consequence, the AICD recommends that consideration be given to the regulation of litigation funders through appropriate state supervisorial bodies, such as the Victorian Legal Services Board + Commission (**VLSBC**). To achieve uniformity it would be desirable for such a regulatory model to be rolled-out to other states and territories.

(c) The AICD supports a number of the suggested changes to improve disclosure requirements on litigation funders and lawyers representing funded plaintiffs in respect of advice about the progress, costs, and possible outcomes of proceedings. The AICD also supports changes to the regulation of group proceedings commenced under Part 4A of

the *Supreme Court Act 1986* (Vic). Our views on these proposals are set out in a Table in section 4 below.

2. Characteristics of an appropriate regulatory regime for litigation funders

The AICD has consistently argued that litigation funders should be subject to an appropriate and nationally consistent regulatory regime that goes beyond the need to simply have adequate conflicts of interest arrangements in place, as is presently the case under the *Corporations Regulations 2001* (Cth) (**Corporations Regulations**). In our view, the regulatory regime should include a comprehensive licensing regime for litigation funders.

The AICD acknowledges the important role that court-supervised regulation of litigation funders has played in mitigating some of the risks associated with funded proceedings. However, the AICD is concerned that this approach will become increasingly inadequate given the growth in funded class actions and the demands this model places on the courts. The current model requires the courts to perform a significant degree of supervision and control over proceedings which are already highly complex, fraught, and lengthy. It also assumes that the courts will be informed of the existence of a litigation funding arrangement, which may not always be the case (particularly for unitary litigation).

In addition, court-based supervision cannot provide parties to a dispute with meaningful protection prior to the commencement of proceedings, when they are arguably most vulnerable to misinformation or pressure, or exposed to conflicts. This risk is particularly acute given the rise of closed-class litigation, where a group member may be approached to enter into a litigation funding agreement with little to no understanding of what alternatives there might be.

The AICD is not alone in calling for regulation and licensing for litigation funders. Appropriate licensing was a recommendation of the Productivity Commission in 2014 and is supported by numerous academics and legal professionals.[1]

We are of the view that an appropriate regulatory regime for litigation funding should include the characteristics discussed below. However, as litigation funding continues to grow and more 'innovative' market practices are explored by commercial litigation funders, we acknowledge that regulation will need to adapt to cover new market practices.

(a) Protection of group members

Litigation funding schemes are based on allowing persons with no direct or subject matter interest in the outcome of the proceedings to pay the costs of litigation in return for a share of the proceeds if the litigation is successful. The policy basis for allowing these types of arrangements is to facilitate class actions which in turn facilitate access to justice. Given this rationale, a common set of procedural safeguards should be implemented to improve the protection of group members.

To achieve this, specific minimum safeguards should be included in any licensing regime for litigation funders. Given that it is often prior to the commencement of proceedings when the protection of group members is most warranted, we are of the view that an appropriate regulatory regime would:

- Ensure that potential group members are not misled or deceived by litigation funders who are promoting a litigation funding arrangement;
- Require the disclosure of any potential conflicts of interests involving the funder, to the potential group members;
- Require the funder to have in place appropriate procedures for managing conflicts of interest and to disclose those policies and procedures to group members prior to entering into a litigation funding agreement;

[1] Productivity Commission, *Access to Justice Arrangements,* Inquiry Report No 72 (2014) recommendation 18.2.

- Require an appropriate dispute resolution procedure to be put in place and disclosed to group members prior to their entry into a litigation funding agreement; and
- Require funders to encourage potential group members to seek independent legal advice prior to their entry into a litigation funding agreement.

(b) Prudential supervision

Litigation funding agreements involve an undertaking of significant financial risk, particularly in the context of complex class actions. In this way, the nature of a litigation funding agreement is analogous to an insurance policy or credit facility.

However, unlike general insurers, superannuation funds, life insurers, private health insurers, and other entities which regularly make financial promises, litigation funders are not subject to meaningful prudential supervision.

Should there be concerns relating to the financial soundness of a litigation funder, the AICD queries whether a court would have the time, resources, and expertise to fully interrogate a funder's prudential risk profile. We consider that it is an inefficient use of court resources to require this kind of analysis to be undertaken for every funded class action which comes before the courts. Nor is it desirable for parties to be required to expend resources and time on potentially complex security for costs applications.

It would also be challenging for the courts to undertake meaningful analysis of a funder's true financial position in an aggregate sense. A court, when determining whether to grant security for costs orders, is unlikely to be in a position to undertake an inquiry into the extent to which a third party funder has made funding commitments to multiple parties across multiple jurisdictions. In some circumstances, a litigation funder may invest in a portfolio of litigation (rather than an individual proceeding) meaning that the risk profile is not ascertainable through an examination of the capacity of a funder to meet the costs of an individual case.[2]

While it may be argued that this issue is adequately dealt with by the defendant making a security for costs application, it is important to note that:

- A defendant may not be successful in obtaining security for costs;
- A security for costs order is generally made at the early stages of the proceedings where the length, complexity and likely cost of the proceeding is unknown and the strength of the defendants case may not be fully appreciated; and
- If a security for costs order is made, courts commonly take a conservative approach to the amount awarded and the security will rarely cover all the defendant's costs in the proceeding.

The comments of Justice Heydon in *Jeffrey & Katauskas v SST Consulting* are particularly relevant here:[3]

> *Defendants are frequently in a dilemma. If they seek security speedily they are accused of applying to early. If they do not seek it speedily they may obtain securities only for the future, not the past, and may not even obtain security for the future. Judges are reluctant to order security for costs in large amounts perhaps fearing that this will simply prolong the litigation in an ill-disciplined way. "The amount awarded as security is no more than an estimate of future costs and it is not reasonable to expect a defendant to make further applications to the court at every stage when it appears that costs are escalating so as to render the amount of security previously awarded insufficient."[4] The lack of judicial*

[2] Productivity Commission, *Access to Justice Arrangements,* Inquiry Report No 72 (2014) Vol 2, 631.
[3] *Jeffery & Katauskas v SST Consulting* (2009) 239 CLR 75 per Heydon J (dissenting), at 118-119.
[4] Heydon J citing *Knight v FP Special Assets Ltd* (1992) 174 CLR 178 at 190 – 191 per Mason CJ and Dean J.

generosity is one of several signs that applications seeking security for costs have little attraction for judges.

The collapse of a litigation funder mid-way through large-scale and expensive litigation would be damaging for all parties concerned. In addition, there is no mechanism in place to prevent litigation funders structuring their affairs to ensure that assets are protected in the event of an adverse costs order, leaving claimants or defendants with no avenue to recover costs. This danger is particularly acute for offshore litigation funders with assets based oversees.

The AICD is firmly of the view that if third party funders are allowed to be involved in extensive, time-consuming and costly litigation against corporations and directors for the purpose of obtaining profit, funders should be subject to prudential requirements to ensure that they have sufficient assets to meet any costs orders made against them. Unfortunately, the Regulations in place do not establish this obligation.

(c) Licensing

As observed in the Consultation Paper, at present there is no tailored licensing for litigation funders, meaning that any person or entity can engage in the business of litigation funding without any licence.

The AICD is concerned that this lack of any form of licensing could enable persons who are not fit and proper to provide funding services to litigation. As one example, a person who is disqualified from legal practice is be able to operate as an officer or employee of a litigation funding business. While this may be appropriate in some circumstances, given the significant and growing role of litigation funders in class actions it is in the public interest for some checks and balances to be put in place.

The AICD is also concerned that there are currently no checks in place to ascertain whether a new entrant litigation funder has adequate conflicts management processes in place. Given the growing presence of off-shore litigation funders in the Australian market, it is imperative that conflict management is being managed appropriately.

The AICD is also concerned that if foreign funders only hold assets outside of Australia it may be difficult for parties to enforce orders and, if the funder refuses to pay, the assistance of foreign courts may be required. It is important that group members can enforce the terms of litigation funding agreements against foreign litigation funders. If this is not possible, successful corporate defendants may be unable to effectively retrieve the costs of defending the proceedings causing detriment to the corporation involved, its shareholders, employees, creditors, and government tax revenue.

(d) Operating as a legal service provider

The AICD consider that any regulatory regime should take into consideration the significant control and influence that a litigation funder can exercise over the conduct of litigation. Through the contractual arrangements made with lawyers and plaintiffs, litigation funders perform a role which is similar to that of a legal practitioner, including directing proceedings, recommending certain tactics in litigation, and receiving confidential and privileged client information.

Despite this, litigation funders are not bound by any of the usual rules or regulations which apply to lawyers and legal practices. Nor are there any real guidelines or restrictions on the funding agreements which can apply to class members and impact on their legal rights substantially.

The difficulties brought about by the involvement of third parties in the lawyer/client relationship were highlighted succinctly in a 2012 discussion paper released by the Office of the Legal Services Commissioner of NSW. The paper, which argued for regulation of litigation funders, observed the following:[5]

[5] Office of the Legal Services Commissioner of NSW, 'The regulation of third party litigation funding in Australia – Discussion Paper' (March 2012), 5.

> *The interpolation of third parties (and sometimes agents and contractors of those third parties) into the traditional lawyer/client relationship however has profound practical and regulatory implications. The interpolation of players who are not bound by traditional duties to the court and the administration of justice, but who are nevertheless increasingly actively managing the process is concerning. The traditional protections afforded to consumers through the long-established rules of legal professional conduct and ethics may provide insufficient in this new legal landscape.*

We also note that a similar point was raised by the VLRC in its Final Report on Civil Justice. In this report the VLRC observed:[6]

> *Because litigation funders and insurers often exercise direct or indirect influence or control over the forensic conduct of parties that they are funding or indemnifying in civil proceedings the commission is of the view that they should be subject to the same obligations as litigants and lawyers. Thus, all relevant participants in litigation would be subject to the same standards and sanctions.*

(e) Certainty

The AICD is concerned that the Corporations Regulations leave a number of concerns and uncertainties related to litigation funding unaddressed and that this will continue to impose a burden on participants in class action proceedings. This is because ancillary or satellite litigation, which seeks clarification from courts as to the nature of litigation funding agreements and the conduct of litigation funders is likely to continue.

The implementation of a regulatory regime which is specifically tailored to address the key areas of concern relating to litigation funding would limit further ancillary or satellite litigation, reducing the costs of all the parties involved. Unfortunately, the Corporations Regulations in place do not provide sufficient certainty for participants involved in funded litigation.

3. Preferred approach to the regulation of litigation funders

The AICD's long-standing preference is for a nationally consistent regulatory regime for litigation funders, implemented by the introduction of a federal laws and regulations that address at a minimum the aspects of an appropriate regulatory regime for litigation funders referred to in section 1 above. Alternative models for implementing a national licensing regime include requiring litigation funders to obtain an Australian Financial Services License (**AFSL**) with specific litigation funding conditions which address the necessary features of a regulatory regime referred to in section 1 above.

However, we recognise that the VLRC has been asked to report on the supervisory powers of Victorian courts and regulatory bodies, in the absence of any progress on national licensing or regulation. Given this context, the AICD supports consideration of the regulation of litigation funders by an appropriate Victorian regulatory body.

In our view, there would be merit in a model where the Victorian body to regulate and supervise litigation funders is the VLSBC. Given that the funder inserts themselves into the client/lawyer relations, and given that their activities touch on fundamental aspects of the responsibilities of legal professionals and the administration of justice, there is merit in regulation by the body that also regulates legal professionals and legal practices.

As Mark Steve, the then NSW Legal Services Commissioner argued in March 2012:[7]

> *The OLSC submits that the funding of litigation is inherently and intimately connected with the provision of legal services, and the administration of justice. We submit that a*

[6] Victorian Law Reform Commission, 'Civil Justice Review Report', (March 2008).
[7] The Office of the Legal Services Commissioner, 'The Regulation of Third Party Litigation Funding in Australia – Discussion Paper' (March 2012).

litigation funder relationship is thus fiduciary in nature and a litigation funder's primary duty should be to the Court…

We submit that litigation funders ought to be regulated in the same manner as incorporated legal practices, who like litigation funders are also intimately connected with the provision of legal services and the practice of law. This regime requires incorporated legal practices to appoint a legal practitioner director and adopt and implement an "ethical infrastructure" – that is formal and informal management policies, procedures and controls, work team cultures, and habits of interaction and practices – that support and encourage ethical behaviour that is overseen by a legal practitioner.

A tailored Victorian regulatory regime would provide certainty and protection for plaintiffs, defendants and funders operating in the State. A tailored regime would also assist to reduce the ancillary litigation relating to the conduct of litigation funders and the nature of funding agreements, and ultimately contribute to the just, quick and lower cost resolution of disputes.

4. Responses to specific questions

The following table sets out the AICD's response to a select number of questions in the Consultation Paper.

Question	AICD Response
2. What changes, if any, need to be made to the regulation of proceedings in Victoria that are funded by litigation funders to ensure that litigants are not exposed to unfair risks or disproportionate cost burdens?	The AICD recommends that litigation funders be regulated at a federal level to provide for nationally consistent standards of conduct and prudential supervision. However, given the scope of the VLRC's consultation, and in the absence of federal action on this issue, we recommend that consideration be given to establishing a Victorian regulatory regime for litigation funders under the supervision of an appropriate independent statutory body such as the VLSBC.
6. In funded class actions, should lawyers be expressly required to inform class members, and keep them informed, about litigation funding changes in addition to the existing obligation to disclose legal costs and disbursements? If so, how should this requirement be conveyed and enforced?	The AICD supports expressly requiring lawyers to inform any clients or class members, and keep them informed, about litigation funding changes. To convey and enforce these requirements, the AICD recommends that changes be made to relevant professional rules and court practice notes, and enforced by the courts and the Legal Services Board.
10. In funded class actions, should the plaintiff be required to disclose the funding agreement to the Court and/or other parties? If so, how should this requirement be conveyed and enforced?	The AICD supports a requirement that the plaintiff be required to disclose the funding agreement to the court and to the other parties (subject to necessary redaction). In the interests of consistency, the AICD recommends consideration be given to adopting similar procedures to those set out in the Federal Court's Practice Note relating to Class Actions (GPN-CA), which include disclosure requirements and would substantially achieve this disclosure objective.

11. In funded proceedings, other than class actions, should the plaintiff disclose the funding agreement to the court and/or other parties? If so, should this be at the court's discretion or required in all proceedings?	The AICD supports the disclosure of funding agreements to the courts in all funding proceedings, without exception. Until such disclosure is required, plaintiffs remain vulnerable to exploitative or unreasonable funding agreements irrespective of whether the litigation is a class action or not. Exceptions to this requirement will only serve to generate disputes regarding whether disclosure is necessary in any given circumstance.
12. In the absence of Commonwealth regulation relating to capital adequacy, how could the court ensure a litigation funder can meet its financial obligations under the funding agreement.	The AICD has concerns that courts will not have the time or expertise to properly assess the prudential position of a litigation funder in any given instance. Our concerns are consistent with those expressed by the Productivity Commission in 2014, where it noted that the court was unable to assess or verify whether a funder was in a sound position to meet all of its concurrent obligations.[8] We recommend that consideration be given to prudential supervision of litigation funders by appropriate Victorian body with sufficient powers and resources to ensure that litigation funders are prudentially sound, and have appropriate risk management processes are in place. We suggest that the VLSBC is the most appropriate Victorian body to perform this role. However, should the responsibility fall on the courts to undertake some form of oversight over the ability of a litigation funder to meet its financial obligations, it is imperative that full and meaningful disclosure of funding arrangements is required in all circumstances. Plaintiffs will face significant risks if the funding agreements fail to provide adequate protection within their contractual arrangements.
13. Should the existing threshold criteria for commencing a class action be increased? If so, which one or more of the following reforms are appropriate? (a) Introduction of a pre-commencement hearing to certify that certain preliminary criteria are met (b) Legislative amendment of existing threshold requirements under s 33C of the *Supreme Court Act 1986* (Vic);	The AICD supports the early identification of problems with class actions. Early identification and resolution of serious inadequacies in a case will save all parties a significant amount of time and resources, and ultimately be in the interests of justice. Of the three measures proposed in the Consultation Paper, the AICD supports retaining the current commencement criteria under s 33C, but shifting the onus for proving that the class action should continue from the defendant to the plaintiff (option (c)). As suggested by the Consultation Paper, the plaintiffs could be required to establish this at the first case management conference or directions hearing. This sensible adjustment would promote the need for plaintiffs to consider the threshold requirements from the outset, and ensure that the position of potential class members is clear and understood before significant costs are incurred. Resolving issues of cohesion and

[8] Productivity Commission, *Access to Justice Arrangements,* Inquiry Report No 72 (2014) Vol 2, 631.

(c) Placing the onus on the plaintiff at the commencement of proceedings to prove that the threshold requirements under s 33C are met; (d) Other reforms.	commonality from the outset will ultimately reduce costs and unnecessary complications for plaintiffs and defendants as proceedings move forward.
15. Should a specific legislative power be drafted to set out how the court should proceed where competing class actions arise? If not, is some other reform necessary in the way competing class actions are addressed?	The AICD has serious concerns relating to the rise of competing class actions. Defendant corporations can be subject to multiple class actions which arise from a common set of facts and issues. Such competing actions defeat the policy purpose behind class actions as an efficient and cost-effective measure to resolve disputes which involve large numbers of potential plaintiffs. Competing class actions can have a multiplier effect on the costs imposed on a defendant, with no discernible benefit to the class members as a whole. The AICD supports a mechanism that provides the courts with flexibility to ensure that justice is being served in each individual instance. Accordingly, the AICD supports the creation of a specific power for the court to address competing class actions through legislative amendment. This legislative power, as suggested by the Consultation Paper, could include specific and non-mandatory criteria for the court to take into account when selecting a team to run the litigation, while providing the courts with the ultimate discretion as to the selection of teams.

5. Conclusion

We hope our comments will be of assistance to you. If you would like to discuss any aspect of this submission please contact Matt McGirr, Policy Adviser, on (02) 8248 2705 or at mmcgirr@aicd.com.au.

Yours sincerely

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