4 October 2022

Law Council
OF AUSTRALIA
Office of the President

Mr David Pearl
First Assistant Secretary (A/g)
Market Conduct Division
Treasury
Langton Cres
PARKES ACT 2600

By email: MCDLitigationFunding@treasury.gov.au

Dear Mr Pearl

Exemptions for litigation funding schemes

The Law Council welcomes the opportunity to make a submission to the Treasury regarding the Exposure Draft of the Corporations Amendment (Litigation Funding) Regulations 2022 (Cth) (**Draft Regulations**), which seek to alter the regulation of litigation funding schemes pursuant to the *Corporations Act 2001* (Cth) (**Corporations Act**).

The Law Council is grateful for the assistance of the Class Actions Committee of the Law Council's Federal Litigation and Dispute Resolution Section, the Financial Services Committee of the Law Council's Business Law Section, the Law Society of New South Wales, the Law Society of South Australia (**LSSA**) and the Law Society of Western Australia in the preparation of this submission.

As set out in the Exposure Draft Explanatory Statement, the purpose of the Draft Regulations is to amend the *Corporations Regulations 2001* (Cth) to provide litigation funding schemes with an explicit exemption from the Corporations Act's: managed investment scheme (**MIS**) regime; Australian financial services licence (**AFSL**) requirements; product disclosure regime; and anti-hawking provisions (for instance, relating to unsolicited sales of financial products).

MIS regime

The Draft Regulations are also a response to the decision of the Full Court of the Federal Court of Australia in *LCM Funding Pty Ltd v Stanwell Corporation Ltd* [2022] FCAFC 103 (***LCM***), which found that class actions are not MISs for the purpose of the Corporations Act, thereby reversing previous authority in *Brookfield Multiplex Ltd v International Litigation Funding Partners Pty Ltd* (2009) 180 FCR 11. The Law Council notes the comments of Lee J in *LCM* that litigation schemes were ill-fitted for the MIS regime, including that such a characterisation was akin to trying to place 'a square peg in a round hole'.[1]

[1] *LCM Funding Pty Ltd v Stanwell Corporation Ltd* [2022] FCAFC 103, [7].

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The Law Council previously opposed the application of the MIS regime to the litigation funding industry.[2] The Law Council shares his Honour's view that the MIS regime was not designed or intended to regulate the litigation funding industry and considers that the MIS regime is not the appropriate tool to regulate litigation funders.

The Law Council therefore is of the view that the Draft Regulations, as they relate to MIS regimes, provide an appropriate exemption as well as greater certainty for industry in light of the *LCM* case.

Licensing of litigation funders

It is noted that the Draft Regulations would go further than undoing the application of the MIS regime by also exempting litigation funding schemes from the AFSL requirements. The Law Council has previously expressed support for the application of a licensing regime, either the AFSL regime or a new regime, to litigation funding schemes.

Should this exemption proceed, the Law Council considers that a bespoke and fit-for-purpose licensing regime for funders of class actions, introduced through amendments to the Corporations Act or the *Australian Securities and Investments Commission Act 2001* (Cth) (**ASIC Act**), could be considered by the Australian Government.

Additional regulation of the litigation funding industry might impact on the availability of litigation funding (by creating a barrier to entry into the market) thereby potentially impacting on access to justice. However, the Law Council considers that an appropriately targeted licensing regime could substantially limit this impact while providing some enhanced consumer protections for class members. In designing a licensing regime, both the conditions of the licence and the form of the regime require careful consideration, and conditions should only be imposed to the extent necessary.[3] It is important to ensure that any regulatory scheme protects class members and the integrity of the judicial system but does not overly burden potential litigation funders or prevent potential class members from bringing an action.[4]

Bespoke regulation was extensively addressed by the Australian Law Reform Commission's (**ALRC**) 2018 Report *Integrity, Fairness and Efficiency—An Inquiry into Class Action Proceedings and Third-Party Litigation Funders*.[5] The following potential elements canvassed by the ALRC in that inquiry could be considered in the design of a new licensing regime, namely that a litigation funder should:

- do all things necessary to ensure that their services are provided efficiently, honestly and fairly;
- ensure all communications with class members and potential class members are clear, honest and accurate;
- have adequate arrangements for managing conflicts of interests;

[2] See, eg, Law Council of Australia, Submission No 62 to Australian Law Reform Commission, *Inquiry into Class Action Proceedings and Third-Party Litigation Funders (DP 85)* (17 August 2018) 9-17; Law Council of Australia, Submission No 67 to Parliamentary Joint Committee on Corporations and Financial Services, Parliament of Australia, *Inquiry into litigation funding and the regulation of the class action industry* (16 June 2020) 19-23; Class Actions Committee, Federal Litigation and Dispute Resolution Section, Law Council of Australia, Submission to the Treasury, Regulation Impact Statement – Regulating Litigation Funders Under the Corporations Act (17 July 2020).
[3] Law Council of Australia, Submission No 67 to Parliamentary Joint Committee on Corporations and Financial Services, Parliament of Australia, *Inquiry into litigation funding and the regulation of the class action industry* (16 June 2020) 19.
[4] Ibid 19-20.
[5] Australian Law Reform Commission, *Integrity, Fairness and Efficiency—An Inquiry into Class Action Proceedings and Third-Party Litigation Funders* (Report 134, December 2018).

- have sufficient resources (including financial, technological and human resources);
- have adequate risk management systems;
- have a compliant dispute resolution system; and
- be audited annually.[6]

The list above is not intended to be exhaustive, and it should be noted that differing views on these matters are held by various Law Council Constituent Bodies and Committees.[7] Should the Government consider implementing a bespoke licensing regime it would be important to consult widely with stakeholders on the elements of that regime.

Minimum prudential, conduct, breach reporting, and complaint standards enshrined in the Corporations Act or the ASIC Act could also be considered in designing a bespoke licensing regime—particularly given the internationalisation of funding and limited asset presence in Australia of some funders.

The Law Council recognises that the courts also play an essential role in the regulation of litigation funders. In class actions most of the concerns regarding excessive fees and possible abuse of position by litigation funders can be addressed by the court through active case management, by the imposition of practice requirements, in approving settlements, and by oversight of funding commissions (if the power to do so is confirmed or restored) and lawyers' fees.

However, court supervision may also be confined to the commencement and conclusion of proceedings when it is either too early or too late to diagnose and address concerns. Given this confinement, and considering the significant financial incentives for litigation funders, the Law Council again notes that some additional regulation may be necessary.

Proposals for simplification and clarity

The Law Council understands that the regime, as amended by the Draft Regulations, would operate as follows:

- paragraph 911A(2)(k) of the Corporations Act allows regulations to be made to provide for AFSL exemptions;
- amended regulation 7.6.01(1)(x) would exempt litigation funding scheme service providers from the requirement to hold an AFSL;
- amended regulation 7.6.01AB(1) would then effectively insert subsection 911A(5C) into the Corporations Act, allowing regulations to be made imposing conflicts of interest obligations on litigation funding scheme service providers who are not required to hold an AFSL; and
- the Corporations Act subsection 911A(5C) regulation-making power is then used in regulation 7.6.01AB(2) to (4), as amended, to impose the specific conflicts of interest requirements.

In the Law Council's view, this regime is unnecessarily complex and convoluted. In order to simplify the regime, the Law Council suggests that consideration could be given to:

[6] Australian Law Reform Commission, *Inquiry into Class Action Proceedings and Third-Party Litigation Funders* (Discussion Paper 85, June 2018) Proposal 3–2.
[7] Law Council of Australia, Submission No 62 to Australian Law Reform Commission, *Inquiry into Class Action Proceedings and Third-Party Litigation Funders (DP 85)* (17 August 2018) 13-5.

- amending the exemption from the obligation to hold an AFSL in regulation 7.6.01(1)(x) to cross-refer to the conflicts of interest obligations that a service provider seeking to rely on this exemption would need to meet under regulation 7.6.01AB; and

- amending the Corporations Act itself to insert subsection 911A(5C) and, when such amendment comes into effect, repealing regulation 7.6.01AB(1).

In the Law Council's view, it is preferable that any power to make regulations under the Corporations Act is introduced by an amendment to the Corporations Act itself, rather than by using the Corporations Regulations to create a power in the Corporations Act to make regulations. Placing any amendments to the Corporations Act into the Act itself would also reduce the complexity and improve the navigability of the regime. It would also be consistent with a number of recent Treasury initiatives to amend the Corporations Act to include modified provisions, which were previously made in the Corporations Regulations and/or Australian Securities and Investments Commission (**ASIC**) instruments.

LSSA – Non-profit litigation funding

The LSSA operates the non-profit Litigation Assistance Fund (**LAF**) in South Australia and has consistently expressed the view that non-profit litigation funders, such as the LAF, should be exempt from the regulation of litigation funders.

In 2020, when the new regulatory regime commenced, the LSSA was disappointed to note that it did not distinguish non-profit funders in this way. Despite this, the LAF was successful in individually applying to ASIC for a level of exemption.

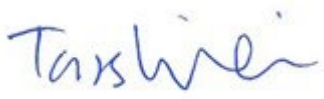
In light of the above, the LSSA is supportive of the regulatory requirements under the Act being removed in the context of non-profit litigation funders.

More broadly, the LSSA notes the context of legal firms that undertake this work on a similar basis thereby offering litigants a similar service, funding disbursements and other costs of a matter at initial stages with a subsequent uplift fee. In a context where the exemption from the relevant regulatory requirements extends beyond non-profit litigation funders, as proposed, the LSSA underlines the similar work being done in-house by the private legal profession. Accordingly, the LSSA suggests that legal practices, which from their own resources fund litigation either in terms of disbursements or legal costs (or both), be subject to the same regulation and have the ability to apply the same uplift as a litigation funder, noting they are effectively providing the same service.

Contact

Please contact Mr John Farrell, Senior Policy Lawyer, on (02) 6246 3724 or at john.farrell@lawcouncil.asn.au in the first instance if you require further information or clarification.

Yours sincerely



Mr Tass Liveris
President