ASSOCIATION OF LITIGATION FUNDERS OF AUSTRALIA

LEVEL 25, 88 PHILLIP STREET, SYDNEY NSW 2000

Association of Litigation Funders of Australia

SUBMISSION TO THE NEW ZEALAND LAW COMMISSION (NZ LAW COMMISSION INQUIRY)

Association of Litigation Funders of Australia

Date: 11 March 2021

Introduction

1. The Association of Litigation Funders of Australia (**AALF**) welcomes the opportunity to make submissions to the Te Aka Matua o te Ture | Law Commission (**NZ Law Commission**) on behalf of its Members.

2. AALF was established in April 2018. AALF members include Investor Claim Partner (**ICP**), Litigation Lending Services (**LLS**), Augusta Ventures (**Augusta**), Vannin Capital (**Vannin**), Balance Legal Capital (**Balance**), Southern Cross Litigation Finance (**Southern Cross**), Premier Litigation Funding (**Premier**), Ironbark Funding (**Ironbark**), Court House Capital (**Court House Capital**) and CASL (**CASL**) (together, **Members**).

3. AALF's primary purpose is to facilitate the enhancement of the Australian Litigation Funding Industry (**Industry**) including, by:

   a. providing education, training and information concerning Litigation Funding and the Industry to its Members and the Industry's stakeholders and prospective plaintiffs;

   b. actively lobbying the Government and legislators, and engaging with other regulators and policymakers to help shape the legal and regulatory framework of Litigation Funding in Australia; and

   c. promoting best practice and ethical behaviour amongst litigation funders in Australia.

4. A copy of AALF's Constitution is attached as **Annexure 1**.

5. One of AALF's first tasks was to establish a set of Best Practice Guidelines (attached as **Annexure 2**) for Members to have regard to when establishing their own policies and procedures.

6. Whilst AALF does not presently have a focus on the Aotearoa New Zealand (**New Zealand**) jurisdiction, some of its members are actively operating in this market. AALF is well placed to assist the NZ Law Commission with its inquiries into class actions and litigation funding, having been at the forefront of the debate in Australia since its inception. In particular, AALF and its Members have sought to help shape the legal and regulatory framework of litigation funding in Australia by:

   a. making oral and written submissions to the Australian Law Reform Commission's (**ALRC**) inquiry into Class Action Proceedings and Third-Party Litigation Funders (**ALRC Inquiry**) in 2018 and 2019. AALF's written submissions to the ALRC Inquiry are attached as **Annexure 3**;

   b. making oral and written submissions to the Parliamentary Joint Committee on Corporations and Financial Services into Litigation Funding and the Regulation of the Class Action Industry (**PJC Inquiry**) in Australia in 2020. AALF's written submissions to the PJC Inquiry are attached as **Annexure 4 and 5**;

   c. successfully applying for leave to be heard at the recent Federal Court of Australia's Full Court hearing in the Seven-Eleven Class Action based on public interest grounds on the question as to whether the Court has power at any time to grant a common fund order in favour of a

funder.[1] AALF's written submissions to the Federal Court of Australia's Full Court are attached as **Annexure 6**;

d. making written submissions to the Australian Treasury in response to the Treasurer's announcement in May 2020 that he would be introducing regulations that would result in litigation funders being required to obtain an Australian Financial Services Licence (**AFSL**) and that funded class actions would be treated as managed investment schemes (**MISs**). AALF''s written submissions to Treasury are attached as **Annexure 7**;

e. making written submissions to the Australian Treasury following the publication of the *Corporations Amendment (Litigation Funding) Regulations* 2020 (Cth) (**Regulations**), which sought to implement the regulatory regime foreshadowed in May 2020. AALF's written submissions to Treasury addressing the unintended consequences of the Regulations are attached as **Annexure 8 & 9**;

f. making written submissions to the Senate Economics Legislation Committee Inquiry into Treasury Laws Amendment (2021 Measures No. 1) Bill (**Senate Economics Committee**), which seeks to amend the continuous disclosure obligations and the misleading and deceptive conduct provisions of the *Corporations Act* 2001 (**Corporations Act**) and the *Australian Securities and Investments Commission Act* 2001 (**ASIC Act**) to remove strict liability for companies and officers that fail to disclose market-sensitive information. AALF's written submissions to the Senate Economics Committee are attached as **Annexure 10**; and

g. held conferences in Sydney and Melbourne in 2018, 2019 and 2020 to discuss and debate issues arising in the Australian class action and litigation funding industry. These conferences attracted lawyers, barristers, insurers, regulators, academics and judges from both the Supreme and Federal Courts of Australia.

7. These submissions do not seek to address all of the matters raised in the Terms of Reference and Issues Paper, but instead, address issues on which AALF feels that it can provide a meaningful contribution. AALF is an Australian Association. As such, it does not provide any commentary on matters specific to the New Zealand legal system or class action regime or any of the cultural issues identified involving a Maori collective. The intention of these submissions is to provide the NZ Law Commission with a good understanding of the class action and litigation funding regime and activity in Australia, and to provide commentary on lessons learnt which may be helpful to the NZ Law Commission when considering their application to the New Zealand jurisdiction.

8. These submissions represent the collective views of the Members, but do not necessarily represent the views of each individual member firm.

Executive Summary

9. Extensive, thorough and detailed consultation with diverse stakeholders is critical to the integrity of the process being undertaken by the NZ Law Commission, and to the recommendations expected to be made to the Minister of Justice in May 2022. In recent times in Australia, we have seen an ad hoc, rushed, and unhelpful political focus on changes to class actions and litigation funding, resulting in regulation that is not fit for purpose and has unintended or unfavourable consequences for access to justice. AALF is supportive of the review being undertaken by the NZ Law Commission, the time frame within which this review is being conducted, and the extensive

[1] *Davaria Pty Limited v 7-Eleven Stores Pty Ltd* [2020] FCAFC 183.

consultation process being undertaken. This comprehensive review will enable considered and careful changes to be made in New Zealand and ones that will be fit for purpose.

10. AALF's key submissions are as follows:

(a) Submission 1 – There are key advantages to all stakeholders in litigation with the implementation of a statutory class action regime with stated disadvantages being overstated.

(b) Submission 2 – AALF supports the implementation of a statutory class action regime that is bespoke for the New Zealand jurisdiction, and agrees with the NZ Law Commission's statement that *"[m]any of the disadvantages of class actions can be mitigated by the design of the regime"*[2]. Further, AALF agrees with the list of principles articulated by the NZ Law Commission to guide the development of a statutory class action regime.

(c) Submission 3 – Australia has a quasi-certification and threshold test and other mechanisms to challenge whether a class action has been properly constituted or should be brought before the courts. The position in Australia ensures that there is adequate access to justice without too much delay and expense, but which also ensures that claims are carefully reviewed and managed by the courts and that adequate and appropriate challenge can be brought by defendants at different stages of the proceeding.

(d) Submission 4 – AALF does not agree that all class actions should be initiated as either open or closed class action because it assumes a 'one size fits all' approach to class actions which is not appropriate. AALF supports the maintenance of the opt-out structure (open classes) coupled with courts being given extensive and wide-ranging powers within a properly drafted statutory class action regime to manage each class action as deemed appropriate.

(e) Submission 5 – There are advantages and disadvantages in the application of the adverse costs rule in Australia. On balance, AALF supports the adverse costs rule in class actions but submits that where this rule is in place, there must be the ability for plaintiffs to access litigation funding and/or after-the-event (**ATE**) insurance.

AALF further submits that a class action costs regime must be simple, easy to follow, devoid of any loopholes, and must be drafted so that the costs of class actions are minimised or reduced.

(f) Submission 6 – AALF submits that Litigation Funding provides and promotes access to justice, without which it is difficult to see how class actions would remain a functioning part of the Australian civil justice system. AALF considers that the NZ Law Commission should be slow to make any recommendations that could have the potential to hamper access to justice and that it should permit and encourage the use of litigation funding in New Zealand class actions, including by abolishing the torts of champerty and maintenance.

(g) Submission 7 – Perceived Problems with Litigation Funding/Funders.

- AALF submits that where specific risks are identified and supported by evidence, those risks should be dealt with on a bespoke and tailored basis (like ASIC Guide 248 – Managing Conflicts of Interest) rather than introducing a breadth of regulation that will inevitably create unintended consequences.

[2] NZ Law Commission *Issues Paper 45, Class actions and Litigation Funding dated 4 December 2020*

- **Funder Control:** AALF supports the position that Litigation Funders do not have ultimate control over all decision-making in the proceeding, and that the Litigation Funder should not interfere with the relationship between the plaintiff and its lawyer.

- **Conflicts of Interest:** AALF submits that it is essential to good business practice to have in place adequate arrangements for managing conflicts of interest. AALF supports the ALRC recommendation that Litigation Funders be subject to the requirements of ASIC Regulatory Guide 248, and that they should be required to report annually to the regulator on their conflict compliance.

- **Funder Profits:** AALF submits that the return on capital enjoyed by Litigation Funders is commensurate with the risk attached to investing in litigation, that any risk of Litigation Funders earning unreasonably high profits from investing in litigation is mitigated by the fact that every settlement of a class action matter requires the approval of the Court, that courts should not have the power to alter contractual commission rates and that statutory provisions regarding caps or maximums are likely to reduce access to justice and create conflicts rather than protect class members.

- **Capital Adequacy:** AALF submits that capital adequacy concerns are unfounded and are not based on any evidence of real cases of concern, and that courts should be given extensive and wide-ranging powers, within a properly drafted statutory class action regime, to case manage each class action as is deemed appropriate, including with respect to making orders for security for costs.

(h) Submission 8 – AALF supports sensible and measured regulatory changes that balance improving consumer outcomes to ensure a properly functioning market for Litigation Funding. AALF does not support the Australian Government's approach to imposing the existing AFSL and MIS regulatory structures. These are unsuitable for a Litigation Funding context and inappropriate for Litigation Funders (and Class Actions) to be subject to these regulations.

11. AALF's key submissions are developed below.

Submission 1 – Advantages and Disadvantages of Class Actions

12. A class action or "representative action" is a court proceeding where the claims of a group or "class" of people are brought by one or a small number of named representatives. In Australia, there have been class action regimes in both the Federal Court and in the State Supreme Courts since 1992.

13. AALF views some of the key **advantages** of class actions as:

(a) **For individual claimants:** providing a means by which individuals, who would otherwise be unable to bring a claim, group together in the pursuit of access to justice. Some of the reasons why these individuals may not be able to bring a claim are:

- the size of the financial resources of the individual plaintiff versus the defendant. Litigation is expensive, and sometimes, where the case is complex, lawyers will advise clients that the claim is legally strong but uncommercial to run. Class actions can assist by making these claims commercially viable and thus worth pursuing;

- In jurisdictions like New Zealand and Australia, where a party who is unsuccessful in its claim has to pay its own legal costs and those of the successful party, the risks of litigation are significant, which has a dampening effect on access to justice. In bringing together groups of people to make a claim against one or multiple defendants, the

adverse costs exposure reduces or is removed in cases where litigation funding is in place; and

- the time that it often takes a claim to resolve in the Courts, sometimes in excess of 3 years. In circumstances where you have a class action, and therefore a lead plaintiff and group members, it provides parties with the opportunity to benefit from the proceeds of litigation without the significant effort and contribution that would be required if they were the only party to the litigation. Further, the sheer size of the claim and the resources behind it may encourage settlement at an earlier opportunity than trial.

(b) **For defendants:** providing a degree of certainty and finality of claims by ensuring that all claims are brought in a timely and uniform way. This helps to avoid duplicity of claims which ultimately results in cost savings.

(c) For the courts: class actions are usually determined by one judge in one court, so problems associated with duplicity and inconsistent judgements are often avoided. Another benefit is the fact that running a single claim with a lead plaintiff and, often many thousands of group members, takes the pressure off already stretched court resources and court lists.

(d) For the economy: successful class actions are likely to have a deterrent effect on corporate wrongdoing. The size of the financial awards or settlements, together with the scrutiny and impact on brand and reputation, is likely to result in a concentrated focus at the board-level on compliance issues and, therefore, a higher standard of corporate behaviour. Class actions enable parties to seek redress for corporate misconduct and provide deterrence against future contraventions.

14. The NZ Law Commission has articulated several **disadvantages** of class actions. AALF does not agree that these disadvantages are real and present dangers and makes the following observations:

(a) Class actions may increase the courts' workload, but this should not be a major consideration as access to the courts and justice are significantly more important than short term resourcing concerns. Any suggestion that class actions or Litigation Funding leads to a flood of filing of opportunistic or unmeritorious suits should be ignored[3]. Litigation Funders do not invest in claims which lack merit because to do so would jeopardise their capital. In practice, substantial due diligence occurs before deciding to fund litigation. The suggestion that Litigation Funding and class actions lead to a flood of filing of opportunistic or unmeritorious suits assumes that members act in a commercially irrational way. This suggestion should be dismissed. Meritorious claims should find easy access to justice without concerns about court resourcing pressures;

(b) Class actions do not unreasonably increase the costs of defendants defending class actions.

Class actions do cost many millions of dollars to run, in part due to the types of claims, the number of group members impacted and in part due to the vigorous defence of some claims. In jurisdictions like Australia and New Zealand, where a party who is unsuccessful in its claim has to pay not only its own legal costs but those of the successful party, the risks of litigation are significant. Class actions reduce the chance of duplicity of claims by ensuring that all claims are brought together in a timely and uniform way. This ultimately results in cost savings to all stakeholders, in particular, the defendants.

[3] Shareholder class actions in Australia – myths v facts by Prof Vince Morabito dated November 2019

Further, it is not the experience of AALF's Members that Australian companies have no practical choice except to settle "flimsy suits" for large amounts of money. AALF questions how it could ever be attractive for a company (or its insurer) to pay $50 million to settle a case against it, unless the company had received legal advice that there were sufficient prospects of it being unsuccessful in defending the case, to justify such a payment. This is because:

- company directors owe fiduciary duties to act in the best interests of the company, and to act with due care, skill and diligence (e.g. s 180 of the Corporations Act). That is particularly so given that if the company is successful in defending the action, it will be awarded its costs of doing so (which it would claim as against security already provided); and

- it is highly unlikely that any insurer who may have granted indemnity in respect of the company's liability from the claim, would consent to the settlement of a "flimsy suit". As above (but perhaps more so), insurers are not in the business of paying out very large sums of money unless it is reasonably clear that their insured will face substantial difficulties in defending the case at trial. In practice, experience suggests that insurers do not settle large claims without first receiving advice from lawyers that they ought to do so.

(c) Class actions have not been the cause of a decrease in the availability of or an increase in the costs of directors and officer's liability insurance (D&O insurance). If it is in fact established that the cost of D&O insurance is rising, AALF would submit that the NZ Law Commission should not readily assume that this is referrable or solely referrable to class actions, noting, in particular, the significant regulatory action taken by ASIC and others in recent years (following, for example, the Financial Services Royal Commission in Australia). For example, the Financial Services Royal Commission's Final Report indicated that ASIC (for example) must ask itself the question: *"Why not litigate?"*.[4] AALF expects that D&O insurance will have responded to significant costs associated with these actions and that this will have materially increased payouts. It should not be assumed that any increases are attributable solely to class actions.

Further, there is reason to think that class actions are separately priced by insurers. Some D&O policies include cover for the company's liability for securities class actions. This is known as "Side C" cover and is included as an extension to D&O policies, so claims on this cover are also claims on the D&O cover. It seems to AALF that if there is a concern about the impact of securities class action settlements is having on D&O insurance, insurers may be well advised to offer this cover separately. AALF is concerned that this misconception has been exaggerated due to the commercial preferences of insurers.

(d) That class members' interests can be properly protected by the implementation of a fit for purpose statutory class action regime with oversight by the courts. Court supervision, coupled with professional obligations over the conduct of legal practitioners in litigation, can adequately protect the interests of all stakeholders in class actions.

Submission 2 – Statutory Class Action Regime

15. AALF supports the implementation of a fit for purpose statutory class action regime with proper oversight by the courts.

[4] *Final Report, Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry 2019* (vol 1), p.427.

16. The overarching and driving principle behind the development of a statutory class action regime should be to promote access to justice with certainty, predictability and transparency for all stakeholders in a class action, regardless of the area of law or type of claim.

17. In Australia, one statutory class action regime which is working well is contained in Part IVA of the *Federal Court of Australia Act* 1976 (Cth) (**FCA Act**). Part IVA of the FCA Act was introduced in 1992 as the first comprehensive class action regime in Australia.

18. AALF submits that the NZ Law Commission should look carefully at the detail of the regime in Part IVA of the FCA Act as it is robust, has been subject to improvements and refinement over many years, and it provides the certainty, predictability and transparency mentioned as being aspirational targets of a statutory class action regime.

19. Of course, there have been challenges to the Part IVA regime. It is not perfect, however, on balance, it does provide a fit for purpose statutory class action regime in Australia, providing the Court with discretionary powers, through legislation and the inherent powers of the Court, to ensure efficiency and that the interests of justice are served.

20. It is beyond doubt that Australia's class action system can be improved. To encourage that improvement, AALF supports the implementation of the majority of the recommendations from the ALRC Report 134 on Integrity, Fairness and Efficiency – An Inquiry into Class Action Proceedings and Third-Party Litigation Funders (**ALRC Report**).

21. In short, in AALF's opinion, the courts are best placed to manage class actions and adopting a prescriptive legislative approach is not the preferred solution. Courts should be given extensive and wide-ranging powers within a properly drafted statutory class action regime to manage each class action as it is deemed appropriate.

22. The following are, in brief, some of the challenges to funded class actions operating in the Part IVA regime, or suggested changes, together with AALF's submissions on those proposals;

    (a) The Court should be given express powers to reject, vary or set the commission rate in third-party litigation funding agreements. AALF does not consider it appropriate for the Court to have the power to alter arm's length contractual arrangements. To the extent that there is a perceived concern about protecting class members, the Court's powers in respect of the approval of settlements are sufficient to protect class members;

    (b) That all class actions should be initiated as either open or closed class actions only. AALF does not agree with this proposal because it assumes a 'one size fits all' approach to class actions which is not appropriate. This is a highly technical area. The making of precipitous changes could result in prejudice to group members who are unable to prosecute their claims individually, create uncertainty (including for defendants), and perversely may produce more litigation (rather than less);

    (c) That where there are two or more competing class actions, that the Court must determine which one of the proceedings should progress and which one must be stayed. AALF does not support a prescriptive approach and submits that it should be left to the discretion of the Court as to whether it is appropriate in the circumstances to have more than one proceeding on foot at any given time;

    (d) AALF considers that Common Fund Orders (**CFO's**) should be encouraged and that courts should be expressly empowered by legislation to make such orders. CFOs have been demonstrated in recent times to have generated increased competition in the Litigation

Funding market, which has improved consumer outcomes[5]. The Court maintains appropriate supervision of recoveries pursuant to the CFO, such that any prejudice to stakeholders (including, to the extent relevant, the defendant(s)) would be addressable; and

(e) AALF supports changes to Part IVA regime to permit contingency fees for class actions but, to the extent that CFO's or group cost orders are also permitted, these should be extended to plaintiff law firms and Litigation Funders to ensure a level playing field, to enhance access to justice and to encourage competition.

23. AALF agrees with the list of principles articulated by the NZ Law Commission to guide the development of a statutory class action regime. Each of these principles is critical to the operation of a working-class action industry. AALF recommends a strong focus on the costs or proportionality of the class actions. Class actions have become more expensive over the years, and identifying ways to minimise these costs is essential to developing a fit for purpose statutory class action regime. In Australia, the Court has successfully imposed cost orders against practitioners and Litigation Funders, including through the use of referees and contradictors, and relied on its settlement powers and obligations to manage behaviours and to minimise the costs of class actions.

Submission 3 – Certification, Threshold Test and the Representative Plaintiff

24. It was stated by the NZ Law Commission that *"[n]one of the Australian class action regimes have a certification requirement. The Australian regimes do, however, provide mechanisms for defendants to challenge the use of a class action on certain grounds"*[6].

25. AALF agrees that there is no formal certification process to bring a class action in Australia however, there are threshold requirements that must be present before a claim can be issued. The key features of the Part IVA class action regime in Australia include:

(a) threshold requirements:

- there must be seven or more persons with claims against the same defendant (numerosity requirement);
- the claims must be in respect of, or arising out of, the same, similar or related circumstances; and
- the claims must give rise to at least one substantial common issue of law or fact (commonality requirement).

(b) representative plaintiff(s): the claim is brought on behalf of all class members by one (or a small number of) representative plaintiff(s) – the representatives are the only class members to be parties to the proceedings; and

(c) class definition: the class can be defined by a list of names or by a set of criteria – it is not necessary to name members of the class or specify the number of people in the class or the total value of their claims.

26. Further, as the NZ Law Commission correctly points out, there are extensive mechanisms for defendants to challenge a class action on certain grounds including:

[5] 'An evidence-based approach to class action reform in Australia' by Prof Vince Morabito dated 2019.

[6] NZ Law Commission *Issues Paper 45, Class actions and Litigation Funding dated 4 December 2020,* page 12.

(a) Claims against lawyers from filing baseless claims. Those obligations find reflection in rules of conduct precluding legal practitioners from alleging any fact in a court document unless there is a belief on reasonable grounds that the facts known to the practitioner provide a proper basis for making that allegation: r 64 of the Legal Profession Uniform Conduct (Barristers) Rules 2015; r 21.3 of the Legal Profession Uniform Law Australian Solicitors' Conduct Rules 2015. For example, a Class Action filed in the Federal Court of Australia must state the name of the person who prepared the pleading and include "a certificate signed by the lawyer that any factual and legal material available to the lawyer provides a proper basis" for the allegations in the pleading. If this certificate is not provided, or it is false, the claim may be struck out;

(b) Applying to strike out the Statement of Claim, obtaining Summary Judgment, de-classing the proceeding (in the case of a Class Action), discontinuing proceedings if a representative plaintiff is not able to adequately represent the interests of class members and/or obtaining security for costs.

These matters, among other powers of the Court, reduce the likelihood of a baseless claim being brought and increase the chance of them being dismissed in short order.

27. The position in Australia ensures that there is adequate access to justice without too much delay and expense, but which also ensures that unmeritorious claims are not brought or are kept out of the courts.

28. AALF supports the need to protect all stakeholders participating in class actions. It believes that this protection is sufficiently advanced by having certain threshold questions to be met and additional powers by which class actions can be discontinued or struck out. AALF does not support a formal and rigid certification process or approval of a particular representative plaintiff, as it is likely to act as an unreasonable barrier to bringing meritorious claims in a timely and cost-effective fashion.

Submission 4 – Membership of the Class

29. As was set out in submission 2 above, AALF does not agree that all class actions should be initiated as either open or closed class actions only because it assumes a 'one size fits all' approach to class actions which is not appropriate.

30. The various Australian jurisdictions which permit representative proceedings all adopt an "open class" or "opt out" structure for those claims – a deliberate choice of the legislature. Open class claims are so-called because the group members represented by the claim are all persons who fall within a particular definition, irrespective of whether they have been identified, taken any step to join the class or consented to being represented by the claim or not. This has been alternatively explained as claims where class members are 'defined according to whether they have been affected by harm in a particular way',[7] irrespective of whether they have consented or have been individually identified by the plaintiff lawyers.

31. The ALRC described the adoption of this structure and the rationale for doing so, as follows, in their most recent report:

> "The design of the regime encompassed by Part IVA was a matter of careful consideration by the ALRC. Having considered the ALRC's recommendations, the Government determined

[7] Vicki Waye and Vince Morabito, 'When Pragmatism Leads to Unintended Consequences: A Critique of Australia's Unique Closed Class Regime' (2018) 19 *Theoretical Inquiries in Law* 303, 306-7.

that an open class system with an opt-out procedure was preferable on grounds both of equity and efficiency. The then Attorney-General said:

> *It ensures that people, particularly those who are poor or less educated, can obtain redress where they may be unable to take the positive step of having themselves included in the proceeding. It also achieves the goals of obtaining a common, binding decision while leaving a person who wishes to do so free to leave the group and pursue his or her claim separately*.[8]

32. The alternative to an "opt-out" procedure is known as an "opt-in" procedure. This would require the consent of all persons who wish to be part of the claim at the outset, prior to proceedings being commenced. Findings as to liability would be binding only on those people whose consent had been obtained. Because of the difficulty of locating people and the occasional urgency with which claims must be brought, it may be impossible to locate all persons affected before commencing proceedings. In relation to those persons, who might never be informed of the litigation, settlements would not be final, and findings of liability in the "opt-in" class action would not be binding and could be relitigated. This leads to a proliferation of proceedings and costs. Further, where there is a limited fund from which relief can be obtained, those who obtained judgment first in time (i.e. in an "opt-in" procedure) would deplete the available fund, leaving other group members without proportionate or fair recourse to that fund. These considerations led the ALRC to adopt the regime in Part IVA. These considerations remain as powerful and compelling today as they were when Part IVA was first promulgated. For these reasons, AALF supports the maintenance of the opt-out structure (open classes) coupled with court powers to impose CFOs, enabling the Court to apportion the cost of funded proceedings across all successful group members.

33. There are several instances where closed class actions may be more appropriate than open class actions, including but not limited to where:

    (a) a small group of class members exists who are willing to enter into agreements with solicitors and/or a funder rendering the need for an open class redundant and unnecessary;

    (b) the costs of a common fund application and contentious opt-out process outweigh the costs of signing up class members to a funding regime; and

    (c) the approach being taken in one claim, such as the proposed cause of action or claim period, differs from an approach taken in another class action.

34. The breadth of the Federal Court's powers to case manage representative proceedings empowers the Federal Court to take steps regarding closing and opening classes where appropriate. Courts should be given extensive and wide-ranging powers within a properly drafted statutory class action regime to manage each class action as it is deemed appropriate.

35. On the question of what criteria should be applied by the courts in deciding how a class membership should be constituted, AALF submits that there should not be a default or standardised approach to this question, but that instead, courts should be given powers to manage each case as it deems appropriate. Some of the matters which courts could take into account when making this decision, in addition to those set out above, are:

    (a) if a closed class has funding and is commercially viable without the benefit of any common fund order, it ought to be permitted to commence on the basis that the class will be sought to be opened for settlement purposes if the opportunity for settlement arises;

[8] ALRC Report, p.34-35 [1.54].

(b) If there is no other open class proceeding filed at the time the closed class is sought to be opened, there is no reason for there to be any restriction on the filing or processing of the claim in this way;

(c) If there is an open class filed when the closed class is sought to be opened, the Court may determine whether to permit the closed class to open. It may do so, for example, if the closed class proceeding is well progressed or likely to better serve the interests of all potential claimants.

Submission 5 – Adverse Costs

36. AALF agrees with the NZ Law Commission that *"[a]n adverse costs rule can have the benefits of compensating successful litigants for some of their costs (including successful plaintiffs), encouraging parties to settle, discouraging frivolous or vexatious claims and discouraging inappropriate litigation behaviour"*[9].

37. AALF also acknowledges the disadvantages of an adverse costs rule in that, in jurisdictions like New Zealand and Australia, where a party who is unsuccessful in its claim has to pay not only its own legal costs but those of the successful party, the risks of litigation are significant which has a dampening effect on access to justice.

38. The risk of being left with a substantial adverse costs order can therefore be a significant impediment to a claim proceeding. This is particularly the case where the defendant may be well resourced, and the plaintiffs may be individuals whose individual claims would be dwarfed by any potential adverse costs order. Without financial support, it is usually not possible for a lead plaintiff to prosecute a representative proceeding in Australia, given that their individual claim doesn't usually justify the expenditure of cost and their personal exposure to adverse costs.

39. Given these issues, AALF supports the adverse costs rule in litigation but submits that where this rule is in place, there must be the ability for plaintiffs to access litigation funding and after-the-event (**ATE**) insurance.

40. In class actions, Litigation Funders provide the funding to bring a claim and, importantly, provide the security for costs to allow a claim to proceed where it otherwise might not. They agree to indemnify the plaintiff against any adverse costs ordered by the court if the proceedings are unsuccessful, and they often provide this indemnity by obtaining insurance cover from an ATE insurer.

41. The NZ Law Commission has set out some alternatives to, or variations on, the adverse costs rule for class actions, including:

(a) *"A no costs rule for all of the proceeding;*

(b) *A no costs rule for certain stages of the proceeding;*

(c) *A rule where only one party can be liable for adverse costs;*

(d) *A different costs scale for class actions; and*

(e) *Specifying the considerations to be taken into account when determining costs"*[10].

[9] NZ Law Commission *Issues Paper 45, Class actions and Litigation Funding dated 4 December 2020,* page 235.

[10] NZ Law Commission *Issues Paper 45, Class actions and Litigation Funding dated 4 December 2020,* page 236.

42. AALF submits that it is critically important that two things happen when deciding on the most appropriate cost structure. First, the costs regime must be simple, easy to follow and devoid of any loopholes. Second, the costs regime must be drafted in such a way that the costs of class actions are minimised or reduced. Minimising costs means that group members get a higher return because the cost of capital is reduced, commission rates become more competitive, and the adverse costs exposure is minimised.

Submission 6 –Litigation Funders and Law Reform

43. AALF submits that Litigation Funding provides and promotes access to justice, without which it is difficult to see how class actions would remain a functioning part of the Australian civil justice system. AALF considers that the NZ Law Commission should be slow to make any recommendations that could have the potential to hamper access to justice and that it should permit and encourage the use of litigation funding in New Zealand class actions, including by abolishing the torts of champerty and maintenance.

44. As a starting point in Australia, the torts of maintenance and champerty have been abolished in all states and territories except Queensland, Western Australia, and the Northern Territory, paving the way for third-party funding in litigation. Since the decision of the High Court in Campbells Cash and Carry Pty Ltd v Fostif Pty Ltd, it is generally accepted that litigation funding arrangements in states and territories where maintenance and champerty have been abolished are enforceable and not contrary to public policy. The same could not be said for states and territories where these torts had not been formally abolished. This has led to some uncertainty around whether litigation funding is permitted in those jurisdictions. Recently, the Queensland Supreme Court handed down a decision in *Murphy Operator & Ors v Gladstone Ports Corporation & Anor (No 4)* [2019] QSC 228, which held that the litigation funding arrangements were not unenforceable due to the torts of maintenance, champerty or due to public policy despite these torts not being formally abolished in that jurisdiction.

45. Litigation Funders are commercial entities that contract with one or more prospective or actual litigants in respect of the funding of a legal claim. Although they are not parties to the litigation, they provide the funding (including, importantly, security for costs) that allows claims to proceed where they otherwise might not. As the Hon Mark Dreyfus QC, MP, said recently:

> *"[l]itigation funding and class actions provide a vital path to justice for ordinary Australians trying to uphold their rights against wealthy defendants with vastly greater resources"*. [11]

46. The Productivity Commission also recognised that Litigation Funding promotes access to justice, noting:

> *… the access benefits of litigation funding should not be underplayed, particularly in relation to complex matters where the initial costs of investigation and collecting expert evidence may be substantial and the defendant is well resourced. There may also be an advantage for the opposing party as the litigation funder has better resources to meet an adverse costs order should the case it is funding fail.* [12]
>
> *Overall, litigation funding promotes access to justice, and is particularly important in the context of class actions where, although action could create additional benefits*

[11] Media Release dated 12 May 2020 by the Hon Mark Dreyfus QC, MP titled "Class Action and Litigation Funding Inquiry"

[12] Productivity Commission, *Access to Justice Arrangements* (Inquiry Report No 72, 5 September 2014) vol 2, 607.

when viewed from a broader or community-wide perspective, (often inexperienced) claimants might not take action given the scale of their personal costs and benefits.[13]

47. The Productivity Commission also explained that:[14]

> *Litigation funding can promote access to justice by providing finance for the prosecution of genuine claims by plaintiffs who would otherwise lack the resources to proceed. Since funders choose cases based on commercial viability, their involvement favours cases with relatively high costs, large payouts and low risk and is unlikely to improve access in relation to rights-based, non-monetary claims. However, the access benefits of litigation funding should not be underplayed, particularly in relation to complex matters where the initial costs of investigation and collecting expert evidence may be substantial and the defendant is well resourced. There may also be an advantage for the opposing party as the litigation funder has better resources to meet an adverse costs order should the case it is funding fail (SCAG 2006).*

48. The Productivity Commission stated that, along with financial support, Litigation Funders often bring important expertise and experience.[15] They can influence the provision of legal services and ensure that costs are minimised. The Litigation Funder can also assist in developing the case by identifying group members and collecting information to assess the viability of the claim, and assisting with the formulation of the claim theory. Many of the professionals working as Litigation Funders are former lawyers (often former partners of large commercial law firms) with extensive experience running commercial litigation. They bring this experience to bear in assisting with the legal and resolution strategy of funded cases.

49. The Productivity Commission continued:[16]

> *In the case of class actions, litigation funders identify, contact and organise members of the class where it might otherwise be unfeasible for a group of plaintiffs to organise themselves. Moreover, they remove the liability for adverse costs, which is a particularly pronounced disincentive in bringing class actions because non-representative group members are statutorily immune from costs ordered against the representative party (Grave et al. 2012). This means the representative party is normally liable for all adverse costs ordered, but is only entitled to a share of the payout.*

50. In other words, Litigation Funders play a significant role in levelling the playing field in the Australian adversarial justice system. This advantage should be made more readily available to the New Zealand adversarial system as well.

51. Many examples could be cited of the beneficial impact upon ordinary Australians of the role of Litigation Funding in providing access to justice. AALF would highlight the following:

    (a) the "Stolen Wages" Class Action against the State of Queensland, for recovery of underpayments for work undertaken by Aboriginal and Torres Strait Islander people in Queensland between 1939 and 1972. The legal costs and disbursements to bring that proceeding exceeded $12.65M, which is beyond the capacity of any one (or, likely, any group) of the plaintiffs to bring, but yielded a settlement of $190m for the benefit of all group members;

---

[13] Ibid 624.

[14] Productivity Commission, *Access to Justice Arrangements* (Inquiry Report No 72, 5 September 2014) vol 2, 607.

[15] Ibid.

[16] Ibid.

(b) the proceedings against the ratings agency "S&P ", in relation to the ratings given to synthetic collateralised debt obligations prior to the Global Financial Crisis. The legal costs and disbursements to bring that proceeding exceeded $20m, and yielded a settlement of $215m, resulting in a return of significant sums of money to Local Government Authorities, which funds were then able to be applied for the benefit of ratepayers;

(c) the Class Action brought on behalf of Australian motorists against Volkswagon, Audi and Skoda EA189 diesel vehicles, which was initiated in 2015 and finally resolved for between $87m and $127m (depending on the final size of the claimant group) in late 2019; and

(d) the "Banksia Financial Group" Class Action in Victoria, which commenced in 2013 and resolved in late 2017 on the basis that the trustee for debenture-holders would pay $64m to investors, most of whom are retirees.

52. Litigation Funders play an important role in the litigation they fund, but they do not control the litigation. They provide the funding to bring a claim and, importantly, provide the security for costs to allow a claim to proceed where it otherwise might not. They agree to indemnify the claimant against any adverse costs ordered by the court if the proceedings are unsuccessful. The risk of being left with a substantial adverse costs order can be a significant impediment to a claim proceeding. This is particularly the case where the respondent may be well resourced, and the claimants may be individuals whose individual claims would be dwarfed by any potential adverse costs order.

53. In a report provided by Professor Morabito of Monash University entitled Market Shares of Litigation Funders in Australia's Class Action Market (**Morabito AALF Report**), for calendar years 2014 to 2018, Professor Morabito identified 217 Class Actions which were commenced in the four Class Action jurisdictions (Federal Court of Australia, Supreme Court of New South Wales, Supreme Court of Victoria and Supreme Court of Queensland).[17] Of those 217 Class Actions, 135 (62.2%) of them were supported by Litigation Funding.[18] This can be compared to the ALRC Report 2019 which found that between March 2017 and 2018 (i.e. looking just at the latter half of the four year period reviewed by Professor Morabito):[19]

(a) 78% (21) of filed proceedings were supported by Litigation Funders; and

(b) 77% (10) of finalised proceedings were funded.

54. The ALRC Report illustrated the growth in Litigation Funding for Class Actions in the Federal Court in Figure 3.1 and Table 3.2:[20]

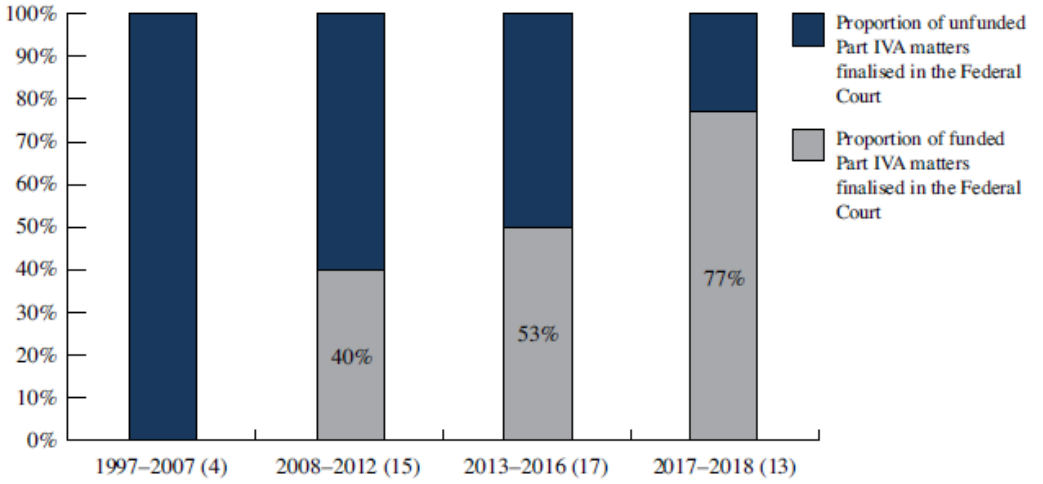
[17] Vince Morabito, *Market Shares of Litigation Funders in Australia's Class Action Market* (Report commissioned by the Association of Litigation Funders of Australia, September 2019).

[18] Ibid 3

[19] Australian Law Reform Commission, Integrity, Fairness and Efficiency—An Inquiry into Class Action Proceedings and Third-Party Litigation Funders (Final Report No. 134 December 2018), 74.

[20] Ibid 74-75.

Figure 3.1: Proportion of finalised Part IVA proceedings that received third-party litigation funding (1997–October 2018)



Source: ALRC Snapshot, Appendix F

Table 3.2: Total number of class action proceedings filed in the Federal Court of Australia and the percentage that were funded (1992–2018)

Time period	Total number of class action proceedings filed in the FC	Total number of filed class action proceedings that were funded	% of filed class action proceedings that were funded
March 1992—March 2013	311	46	15%
March 2013—March 2018	111	71	64%
March 2017—March 2018 (subset of above)	27	21	78%
TOTAL filed on/before March 2018	**422**	**117**	**28%**

Source: Professor Vince Morabito, Private correspondence (13 March 2018)

55. Professor Morabito's study suggested that the results obtained on behalf of plaintiffs in funded litigation is significantly higher than the results obtained in unfunded litigation:[21]

> *… the mean gross settlement fund and the median gross settlement fund in funded Part IVA proceedings – $48,218,333 and $38,500,000, respectively – were substantially greater than corresponding settlement funds for non-funded Part IVA proceedings: $16,987,659 and $3,100,000, respectively…*

56. It is therefore apparent that Litigation Funders are providing and promoting access to justice for ordinary Australians. AALF supports this approach being taken in New Zealand as well. It is important to eliminate the uncertainty about the permissibility of litigation funding to encourage litigation funding of class actions in the New Zealand market.

57. There are some perceived problems with litigation funding/funders and these will be addressed in detail in submission 7 below.

[21] Vince Morabito, 'Lessons from Australia on Class Action Reform in New Zealand' (2018) 24 *New Zealand Business Law Quarterly* 178, 202.

Submission 7 – Perceived problems with Litigation Funding/Funders

58. In this section of the submissions, AALF responds to some of the perceived problems with Litigation Funding and Funders, including:

    (a) Funder control of litigation;

    (b) Conflicts of interest;

    (c) Funder profits; and

    (d) Capital adequacy.

59. AALF submits that where specific risks are identified and supported by evidence, those risks should be dealt with on a bespoke and tailored basis (like ASIC Guide 248 – Managing Conflicts of Interest) rather than introducing a breadth of regulation that will inevitably create unintended consequences.

60. **Funder Control:**

    A Litigation Funder and plaintiff will enter into a Litigation Funding Agreement that will state that the plaintiff retains ultimate control of the proceeding and that the Litigation Funder should not interfere with the relationship between the plaintiff and its lawyer. AALF fully supports this position, and it is satisfied that the status quo is working well.

61. **Conflicts of Interest:**

    Litigation Funders operating in Australia are subject to the requirements of ASIC Regulatory Guide 248, which sets out the regulatory approach to maintaining adequate practices and following certain procedures for managing potential and actual conflicts of interest in relation to a litigation scheme or a proof of debt scheme. This is presently the only regulation that applies to Litigation Funders in Australia.

    AALF submits that it is essential to good business practice to have in place adequate arrangements for managing conflicts of interest. To this end, AALF's Best Practice Guidelines provides that *"[m]embers should publish, or alternatively, provide a copy of their privacy and conflicts policies that conform with relevant regulations to each Funded Party in their pre-contract disclosure documents or as an attachment to the LFA, and they should comply with those policies"*.

    Further, recommendation 15 of the ALRC Report states that this regulatory guide should be amended to require Litigation Funders to report annually to the regulator on their compliance with the requirement to implement adequate practices and procedures to manage conflicts of interest. AALF fully supports this recommendation.

62. **Funder Profits:**

    AALF submits that the return on capital enjoyed by Litigation Funders is commensurate with the risk attached to investing in litigation.

    It is important to remember that without financial support, it is often not possible for a lead plaintiff to prosecute a representative proceeding, given that their individual claim would never justify the expenditure of cost and their personal exposure to adverse costs. That Litigation Funders expect to generate a return on the capital they have provided to the plaintiff should be uncontroversial. There is no practical difference between this commercial outcome and that of a solicitor, acting in a no-win, no fee structure, who has a margin of return above costs in their professional rates (as all professionals do).

In Australia, any risk of Litigation Funders earning unreasonably high profits from investing in litigation is mitigated by the fact that every settlement of a class action matter requires the approval of the Court that the terms of the settlement (including the amount of any payment to a Litigation Funder), is fair and reasonable.

AALF supports the courts' approval requirement but does not consider the courts should have the power to alter contractual commission rates. Funding fees need to adequately compensate for risk at the time the funding agreement is entered into and should not be set retrospectively by the court when the outcome of the case is known. Competition now evident in the market is the best mechanism to set fees rather than assuming that the judiciary is better placed to assess in hindsight what a fair balance of risk and return is for a given case.

Further, AALF submits that statutory provisions regarding caps or maximums are likely to reduce access to justice and create conflicts rather than protect class members. The Federal Court already considers the proportionality of a commission rate to a settlement when determining whether to approve a settlement. Introducing statutory caps or maximums will stymie competition and may create a tendency for funders to charge fees at the caps and assumes the legislature is better placed than the market to determine a reasonable risk/return rate.

Another unintended consequence of introducing statutory caps is the potential conflict it may create regarding the settlement of a claim. If a funder is faced with a statutory cap, it may be placed in a position where it cannot commercially propose an early settlement offer because its returns will make the outcome commercially unattractive/unviable.

63. **Capital Adequacy:**

Capital adequacy requirements have been proposed in Australia to be similar to that required by the Association of Litigation Funders in the UK, being:

(a) to maintain at all times access to adequate financial resources to meet the financial obligations of the funder and in particular to ensure that it maintains the capacity:

- to pay all debts as and when they become due and payable; and
- to have access to capital to meet its aggregate funding liabilities under all of its litigation funding agreements;

(b) to maintain access within 4 weeks to a minimum of $1million in capital or such other amount as is stipulated by regulation from time to time;

(c) to have a continuous disclosure obligation in respect of its capital adequacy, including a specific obligation to notify ASIC promptly if it reasonably believes it is in breach of its capital adequacy obligations;

(d) to be required to submit an annual audit report by an independent audit firm containing an audit opinion:

- on the funder's most recent annual financial statements prepared in accordance with the requirements of the jurisdiction where the company is incorporated (but not the underlying financial statements) within one month of receipt of the opinion and in any case within six months of each fiscal year-end. If the audit opinion provided is qualified (except as to any emphasis of matters relating to the uncertainty of valuing relevant litigation funding investments) or expresses any question as to the ability of the firm to continue as a going concern, the funder will respond fully to any ASIC queries;
- on whether the funder satisfies the minimum capital requirement prevailing as at the relevant date; and

- to comply with any capital adequacy requirements stipulated by regulation from time to time.

Further, recommendation 12 in the ALRC Report stated that Part IVA should be amended to provide a statutory presumption that third-party litigation funders who fund representative proceedings will provide security for costs in any such proceedings in a form that is enforceable in Australia.

AALF's submission is that there are few, if any, examples where the lack of capital adequacy of a funder has led to financial loss to plaintiffs either in Australia or the UK in the last 20 years. Despite this, AALF has sought to address this issue by including a requirement in its Best Practice Guidelines that *"[f]unders should maintain at all times access to adequate financial resources to meet the obligations of the Funder to fund all the Relevant Disputes that they have agreed to fund and in particular, should ensure that they maintain the capacity to pay all debts as and when they become due and payable"*[22].

Further:

(a) There are market forces in place to help regulate and/or mitigate this risk. For instance, law firms are unlikely to work with funders where they are concerned about a funder's solvency;

(b) If the funding of a meritorious claim is put into question due to capital inadequacy of the funder, the Australian market is sufficiently mature and deep for substitute funding to be obtained at no additional cost to consumers; and

(c) The courts have adequate powers to order that security for costs be provided in a particular proceeding.

In short, it is AALF's submission that capital adequacy concerns are unfounded and are not based on any evidence of real cases of concern and that courts should be given extensive and wide-ranging powers, within a properly drafted statutory class action regime, to case manage each class action as is deemed appropriate, including with respect to making orders for security for costs.

Submission 8 – Regulation of Funders

2. AALF supports sensible and measured regulatory changes that balance improving consumer outcomes to ensure a properly functioning market for Litigation Funding. AALF does not support the Australian Government's approach to imposing the existing AFSL and MIS regulatory structures as these are unsuitable for a Litigation Funding context and that it is inappropriate for Litigation Funders (and Class Actions) to be subject to this regulation.

3. Regulation of litigation funders in Australia has traditionally been light touch. Until the Federal Government's announcement on 21 May 2020, the only industry-specific regulation that Litigation Funders were subject to was limited to ASIC Regulatory Guide 248 in relation to the management of conflicts.

4. There have been debates over the years, questioning whether licensing and/or regulation of funders is necessary/desired. AALF made extensive submissions to the ALRC on this topic (Annexure 3), specifically that:

[22] Guideline 10 of the AALF Best Practice Guidelines (Annexure 2 to these submissions).

(a) It is counter-intuitive to introduce a licensing regime for litigation funders where the types of licensing conditions being contemplated address a problem that does not exist historically, presently, and are not likely to emerge in the future;

(b) Where risks are identified and supported by evidence, an alternative approach to a licensing regime may be through introducing ASIC Regulations like RG 248-Managing Conflicts of Interest, which can be tailored to address a specific risk. This may be a more cost-effective and efficient mechanism to target a specific risk or risks, rather than introducing a breadth of regulation that will inevitably create unintended consequences;

(c) whilst there is no evidence to support the need for a licensing regime for third-party funders, AALF does not oppose its introduction provided that it:

- Has regard to the potential it may not add any meaningful value in consumer protection;
- Does not restrict competition, availability of capital (particularly to retail claimants) or the price of the capital;
- Does not cost more than its likely benefits;
- Is subject to adequate consultation; and
- Is imposed with relevant grandfathering and regard to practical impediments that take time to legitimately address.

5. In August 2020, the Australian Government imposed the AFSL and MIS regimes on Litigation Funders and class actions. The stated objectives of the proposed regulatory regime are to:

(a) ensure that only reputable and capable funders enter the market;

(b) reduce the risk of financial loss to the parties by reducing the risk that funders will be unable to meet their liabilities;

(c) encourage compliance by Litigation Funders with their obligations; and

(d) enhance the reputation of Litigation Funders.

6. AALF supports the views of ASIC and the ALRC that the existing AFSL and MIS regulatory structures are unsuitable for a Litigation Funding context and that it is inappropriate for Litigation Funders (and Class Actions) to be subject to these regulations.

7. AALF has made extensive submissions against the imposition of the existing AFSL and MIS regimes, as well as making suggested changes to constructively seek to minimise the unintended negative consequences of regulation. AALF refers to Annexure 5, 8 and 9 as providing a detailed review and commentary on the pros and cons of applying the AFSL and MIS regulatory regime to litigation funding and class actions in Australia. These submissions are specific to the regulatory regime proposed in Australia and so we don't restate these for the purposes of these submissions to the NZ Law Commission.

8. AALF supports the ALRC's proposal of sensible and measured regulatory changes which balance improving consumer outcomes with that of ensuring a properly functioning market for Litigation Funding.

CONCLUSION

1. AALF is grateful to the NZ Law Commission for the opportunity to provide this submission.

2. AALF would welcome the opportunity to present to the NZ Law Commission, to answer any questions, or to provide any further or other assistance it requires.

Association of Litigation Funders of Australia

11 March 2021