AALF

Association of Litigation Funders of Australia

20 August 2021

Litigation Funding Consultation
Australian Securities and Investments Commission
GPO Box 9827
Brisbane QLD 4001

By email: litigation.funding.consultation@asic.gov.au

Dear Investment Managers

Re: Litigation Funding Schemes: Guidance and Relief | ASIC Consultation Paper 345 (CP 345)

1. The Association of Litigation Funders of Australia ("**AALF**") makes this submission to ASIC on behalf of its members in relation to CP 345. AALF is grateful for the opportunity to engage with ASIC in relation to its consultation paper and responds to a number of the consultation items below. For the consultation items not mentioned below, AALF makes no comment at this time.
    a. **B1Q1** – Do you agree we should provide guidance on how the 'managed investment scheme', 'member' and 'scheme property' definitions apply to litigation funding schemes? **Yes, we agree, because guidance will assist market participants.**
    b. **B1Q3** - do you agree with our guidance on the definitions of 'managed investment scheme', 'member' and 'scheme property' to litigation funding schemes? If not, why not? **No – please see detailed submission below.**
    c. **B1Q4 and Q5** - Are there other issues relating to definitions or interpretations of definitions, relevant to litigation funding schemes, on which you consider that guidance is necessary? If so, please provide specifics of the additional issues you consider should be addressed – **Yes - please see submission below**.
    d. **C1Q1** - We propose to grant industry-wide relief from the equal treatment duty to responsible entities of registered litigation funding schemes. Do you agree with the proposed relief? **Yes.**
    e. **C2Q1 and C2Q2** – Do you agree with our proposal to continue the dollar disclosure relief until 22 August 2025? **Yes – as to why please see our previous application for relief annexed hereto.**
    f. **C3Q1** – Proposal not to remake ASIC Credit (Litigation Funding – Exclusion) Instrument 2020/37 – **We do not agree - please see submission below**.

B1Q3

2. AALF does not agree with the guidance provided by ASIC on the definitions of 'managed investment scheme', 'member' and 'scheme property'. In particular, AALF does not agree that the general definition of 'managed investment scheme' (in section 9 of the Corporations Act) requires 'litigation funders' and 'lawyers' to be considered members.

3. Such an interpretation would mean third parties that contract with a responsible entity in a typical 'investment management' related scheme may be considered members. By way of parallel, in practice, an investment management firm that is engaged by a responsible entity (under an investment management agreement) and is entitled to a performance fee is not considered to be a member of the scheme.

4. There is no material benefit from a consumer protection perspective in requiring a responsible entity to view 'litigation funders' and 'lawyers' as members. The policy focus of the 2020 legislative reform is on protecting 'general members'. The rights of 'litigation funders' and 'lawyers' are sufficiently dealt with in the relevant funding agreement and retainer, respectively.

5. Classifying 'litigation funders' and 'lawyers' as members means the responsible entity will need to attempt to comply with its statutory duties to those 'members'. This would include application of the 'best interests', conflict management and other duties under section 601FC and section 912A of the Corporations Act. The duties owed to these classes of 'member' (on the one hand) and general members (on the other hand) may in practice result in irreconcilable conflicts.

6. There are no adverse disclosure consequences if relief was granted, ie, arrangements with 'litigation funders' and 'lawyers' would still be disclosed in the relevant PDS.

7. Accordingly, AALF requests that ASIC provide relief to make it clear that 'litigation funders' and 'lawyers' are not members of a scheme.

B1Q4 and Q5

8. The purpose of *Corporations Amendment (Litigation Funding) Regulations 2020* (Cth) (**New Regulations**) is to ensure greater regulatory oversight and accountability of third-party litigation funders in class actions by requiring them to hold an Australian Financial Services Licence (**AFSL**) and to comply with the managed investment scheme (**MIS**) regime under the *Corporations Act 2001* (Cth)(**Corps Act**).[1]

9. The New Regulations seek to preserve the existing exemptions to AFSL, disclosure and MIS requirements for insolvency, commercial single-party (non-class action) proceedings.The Explanatory Statement to the New Regulations states this purpose in the following terms**:**

"The Regulations remove the exemptions that apply for litigation funding schemes used in class actions…The Regulations do not remove the effect of the other exemptions that currently apply to certain ***litigation funding schemes in the insolvency context*** *and* ***litigation funding arrangements****"*[2] (emphasis added).

[1] Explanatory Statement, *Corporations Amendment (Litigation Funding) Regulations* 2020, registered 23/07/2020to F2020L00942, p.1.

[2] Ibid. See also, p.4: "The *amendments preserve the effect of other exemptions that currently apply for litigationfunding schemes involved in insolvency litigation and litigation funding arrangements (which are used in actionsinvolving a single plaintiff)"*

10. Third-party litigation funding services are provided in the insolvency and commercial litigation context in the following broad market segments:
    a. Class action proceedings; and
    b. Non-class action proceedings. This segment may be further sub-divided into:
        (i) Insolvency proceedings (single or multiple external funded parties), e.g. funding provided by external litigation funders to joint and several liquidators; groups of companies in liquidation; liquidator and company in liquidation);
        (ii) Liquidation proceedings (creditors or members of the body corporate provide funding) e.g. as envisaged in New Regulation 5C.11.01(3)(b); and
        (iii) General commercial litigation (single or multiple funded parties) – commercial claims;intellectual property; *inter alia*.

11. This submission contends that there is currently an unintended inconsistency between the stated purpose of the New Regulations, namely to regulate third-party funding of *class actions* and their practical effect on third-party funding in the *insolvency and commercial litigation* context.

12. This submission sets out these issues in **Section 2** and **4**, describes the consequences of inaction at **Section 3** and proposes minor regulatory amendments to clarify and remove any ambiguity at **Section 5**.

Section 2 - General scope of issues

13. The current form of the New Regulations:
    a. New Regulation 5C.11.01(3)(b), does not appear to exempt third-party litigation funders providing funding for insolvency proceedings for the purpose of providing an exemption to the AFSL, disclosure and MIS regimes under the Corps Act – it only appears to be limited to circumstances where creditors or members of the body corporate provide funding; and
    b. New Regulation 5C.11.01(5), does not appear to exempt third-party litigation funding of a proceeding which has more than a single funded party but is not a class action, from the AFSL, disclosure and MIS regimes under the Corps Act.

14. The combined effect of the above issues is that the New Regulations appear to adversely impact third-party funded insolvency and commercial litigation and appear to extend beyond their regulatory intent to ensure greater regulatory oversight and accountability of third-party litigation funders in class actions.

Section 3 – Consequences

15. There is a common interest in providing certainty and avoiding ambiguity. The consequences of failing to address these issues are manifold:
    a. A curtailment in funding for insolvency and other commercial cases with the result that otherwise meritorious claims will be stymied or expire as limitation periods elapse.

Relatedly, this may inhibit vital access to justice and redress for creditors and non-class action commercial litigants.

b. The definitional ambiguity created by the New Regulations will increase the likelihood of interlocutory disputes regarding regulatory compliance and encourage satellite litigation which will incur significant costs, distract from substantive proceedings, burden Courts and work against the "Overarching Purpose" of just, efficient, timely and cost-effective resolution of the real issues in dispute.[3]

c. The New Regulations will impose significant regulatory compliance costs upon third-party litigation funders for non-class action proceedings which the New Regulations were intended to exempt.

Section 4 - Specific Issues – Unintended Scope of Exemptions

Insolvency litigation funding scheme – regulation 5C.11.01(3)

16. Third-party funding of insolvency proceedings is unlikely to ordinarily fall within the definition of an *insolvency litigation funding scheme* at 5C.11.01(3) on the following bases:
    a. Regulation 5C.11.01(3) does not include a third-party litigation funder as a defined entity who may "provide funds" for those purposes stated at sub-paragraph (4); and
    b. Relatedly, a third-party litigation funder is not susceptible to the definition of "creditors" or "members of a body corporate" so as to engage sub-paragraph (3).

17. In its current form, the New Regulations have the effect that third-party litigation funders providing services in liquidation proceedings are not exempt from the MIS regime by operation of the New Regulations alone.

Litigation funding arrangement – regulation 5C.11.01(5)

18. The exemption for a *litigation funding arrangement* at regulation 5C.11.01(5) appears to be expressed in the singular and accordingly appears to be engaged only where the dominant purpose of the arrangement relates to the interest of a "general member" (singular).

19. It is common that third-party litigation funders extend funding services in circumstances where more than one interest is represented, for example:
    a. A liquidator (or liquidators) and a company (or companies) in liquidation; and
    b. multiple plaintiffs, in a commercial, non-class action, proceeding.

20. Litigation funding provided in the circumstances above would appear not to satisfy the definition of a *litigation funding arrangement* at 5C.11.01(5)(a) as each claim involves more than one "general member", as defined in regulation 5C.11.01(6). In the liquidation context, this construction would enable only a third-party litigation funder to fund a single party

[3] The Overarching Purpose is embodied in the civil procedure rules of all state and Federal Courts. See for example section 37M of the Federal Court Of Australia Act 1976, Section 7 of the Civil Procedure Act (Vic), Section 56 of the Civil Procedure Act 2005 (NSW)

liquidation proceeding. In the context of general commercial claims it would similarly limit third-party funding to exempted 'single plaintiff' claims.

Definitional ambiguity – "general member"

21. Relatedly, regulation 5C.11.01(6) introduces a definitional ambiguity between a "general member" and an "external administrator" for the purpose of satisfying 5C.11.01(5)(a). It is unclear whether an external administrator, which includes an administrator, a liquidator (including a provisional liquidator) and a controller, may be construed as a "general member" under regulation 5C.11.01(6).

22. As the definition of a "general member" is defined in the negative, that is by what it is not, it may be susceptible to a construction which includes an "external administrator" as a "general member" for the purpose of engaging 5C11.01(5)(a). This exposes a definitional tension within 5C.11.01(6), wherein a party can simultaneously be both an "external administrator" and a "general member". This ambiguity is apt to encourage interlocutory disputes and create uncertainty for litigants and funders.

Litigation funding scheme – regulation 7.1.04N(3)

23. The definition of a *litigation funding scheme* at regulation 7.1.04N(3) is so broad as to capture proceedings described above in which third-party funding is provided in a multiple- party proceeding which is *not a class action*. In these circumstances, litigation funding for a non-class action would be considered a financial product and subject to the costly and onerous disclosure regime under Part 7.9 of the Corps Act.[4]

Section 5 - Potential Solutions

24. The issues identified at Section 4 may be addressed by the following minor amendments to 5C.11.01 and 7.1.04N.

    a. *Insolvency litigation funding scheme* - include third-party litigation funders as a defined entity who may "provide funds" under regulation 5C.11.01(3)(b), in addition to creditors and members.
    b. *Litigation funding arrangement* – amend regulation 5C.11.01(5)(a) to include the plural ("general members") but exclude a *litigation funding scheme* (i.e. class actions).
    c. *Litigation funding scheme* – clarify that 7.1.04N(3) applies only to class actions and does not apply to multi-party proceedings that are not class actions (ie, representative proceedings as constituted under applicable Court rules).

[4] New Regulation 7.9.98A removes the exemption for a *litigation funding scheme* to comply with Part 7.9 of the *Corporations Act 2001* (Cth), but retains the exemption for an *insolvency litigation funding scheme* and a *litigation funding arrangement*.

C3Q1

25. The purpose of this submission is to request that ASIC extend the relief granted under the *ASIC Credit (Litigation Funding-Exclusion) Instrument 2020/37* ("**the Credit Instrument**") post 31 January 2023.

26. By way of background, litigation funding is a non-recourse 'loan' – that is, if the claim is unsuccessful, the 'loan' balance is not repayable and any 'loan' is only repayable from the proceeds that result from the claim for which the 'loan' is provided.

27. This raises three issues with the applicability of the National Credit Code to litigation funding:
    a. There is no possibility of monetary default on the part of the funded claimant. Accordingly, the 'responsible lending' requirements seem to be irrelevant (Ch 3 National Consumer Credit Protection Act 2009 ("**NCCP**");
    b. The financial hardship requirements (s 72-75 of the NCCP) are irrelevant because the only time the 'loan' is repayable is if, and only if, there is a successful recovery; and
    c. The funds advanced by litigation funders generally do not attract interest payments nor fees, thus the 'credit contract' (s14 of the NCCP) and some of the requisite information to be provided within the 'credit contract' (s17 of the NCCP) would seem to be irrelevant.

28. Absent an extension of the relief, the funding of an individual non-business claimant would likely require the litigation funder to hold an Australian Credit licence – something which we believe would stultify access to justice for these individual claimants as explained below.

29. Below are some real-world examples:

Example A:

- An individual prospective claimant seeking funding to pursue their underpayment claim under the Fair Work Act 2009 against their former employer.

Example B:

- A victim of sexual abuse by an institution seeking litigation funding to pursue their proposed civil actions against said institution for negligence, inter alia.

30. In each of these examples, neither of the claimants could have proceeded without litigation funding. It is our respectful opinion that access to justice for each of these actions is, as a matter of public policy, of critical importance to society. It cannot be right that vulnerable individuals with no resources of their own are subject to rules that purport to protect them, but do not serve that purpose and instead deny them access to justice.

31. In the examples above, post-January 2023, funding of these individual claims would be defined as a 'credit activity' under the NCCP. Therefore, pursuant to paragraph 113-114 of ASIC CP 345, these claims would not '*be subject to the managed investments and AFS licencing regimes under the Corporations Act*'. Further, neither of these claimants would be considered

businesses and therefore would not be exempt from the application of the NCCP. This would be an example of claims 'falling in the gaps' of legislation which could prove to be detrimental to individual non-business claimants.

32. If these claims were brought to the attention of litigation funders post January 2023, the imposition of the National Credit Code requirements would most likely mean that funding either of these actions would be impractical as a litigation funder would need to hold an Australian Credit Licence – the administrative burden would not justify the commercial return, which in these cases tends to be much lower per case than other actions, such as class actions.

33. It is our submission that, given the examples above, the funding of individual non-business claimants may prove too difficult to fund due to ASIC's proposal not to extend the relief under the Credit Instrument. This would be a barrier for access to justice for individual claimants who do not fall under the AFSL/MIS Regulations and who are often the most vulnerable or subject to the greatest disparity of resources. Accordingly, we respectfully disagree with ASIC CP 345 Proposal C3 with respect to individual funded actions as it would reduce access to justice for individual non-business claimants.

Please do not hesitate to contact the undersigned should you have any queries regarding the above or require further clarification.

Yours faithfully,

Pip Murphy
Chief Executive Officer
Association of Litigation Funders of Australia