Australian Government

The Treasury

POST-IMPLEMENTATION REVIEW

Litigation funding
Corporations Amendment Regulation 2012 (No 6)

October 2015

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PURPOSE OF THE POST-IMPLEMENTATION REVIEW

1. In July 2013, the Australian Government introduced the Corporations Amendment Regulation 2012 (No 6) (the Regulation), commencing on 12 July 2013.[1] The Regulation excludes litigation funding schemes and arrangements from the definition of a managed investment scheme (MIS) under the *Corporations Act 2001*. It also provides an exemption from the requirement to hold an Australian financial services licence (AFSL) for persons providing funding as part of either a single-party or multi-party litigation, as long as they have appropriate processes in place for managing conflicts of interest.

2. Australian Government agencies must undertake a post-implementation review (PIR) when regulation has been introduced, removed, or significantly changed without a regulation impact statement (RIS). As an adequate RIS was not prepared for the Regulation, a PIR is required within two years of the regulation being implemented.

1 See the Federal Register of Legislation website.

BACKGROUND

3. Litigation funding is a contractual arrangement whereby a third party (the litigation funder) pays the cost of litigation and in return, if the case is successful, receives a percentage of the proceeds.[2] The litigation funder can either fully or partially fund a litigation action.

4. Litigation funding arrangements are based on a person or entity that is not a party to the litigation and has no direct interest in its outcome, paying the costs of litigation and accepting the associated risks.

5. Litigation funding arrangements (single party) and litigation funding schemes (multi-party) are used in both individual proceedings and in representative proceedings (known as class actions) where plaintiffs require financial support to bring the cases to court and to meet the costs of the respondent if the action is unsuccessful. A class action is a form of lawsuit where a group of seven or more people with claims arising in similar circumstances that give rise to a common issue of law or fact, collectively bring a claim to court. Litigation funders are active in several legal areas but have become increasingly involved with substantial class actions, for example, on behalf of shareholders of large listed companies.

6. In Australia, third party litigation funding originated around 22 years ago out of the financing of insolvency proceedings. Litigation funders gradually expanded into funding large commercial claims and class actions. Through this time, the number of legal proceedings funded by third party litigation funders has remained relatively small.

7. Class actions have become an important part of the court system. Not all class actions involved third party litigation funders. In 22 years of operation (from March 1992 to March 2014), a total of 329 class actions were filed, of which 49 proceedings[3] received financial support from commercial litigation funders.[4] In the two years to June 2015, there were 20 funded class actions out of a total of 50 class actions in that period.[5]

8. There are a number of active litigation funders in Australia, including domestic and overseas firms (see Table 1). Funders primarily finance large-scale litigation, including

2 Legg M., Park E., Turner N. and Travers L., 2011, *The rise and regulation of litigation funding in Australia*, Northern Kentucky Law Review, vol.38 no.4, pp625-672.

3 This does not take account of matters that have been funded but not filed or never filed.

4 Morabito, V. 2014, *Class Action Facts and Figures —Five Years Later*, November, Third Report, An Empirical Study Of Australia's Class Action Regimes, Monash University, Caulfield East, Victoria.

5 King & Wood Mallesons 2014 and 2015, The Review: Class Actions in Australia 2013/14, and 2014/15.

corporate insolvencies, commercial and contractual disputes and securities and consumer protection claims.

9. While class actions have become an important feature of our court system, the costs system in Australia, which generally requires the loser to bear the legal costs of the winner, has prevented an exponential rise in the number of such actions. In particular, this system is effective in preventing actions based on weak or doubtful claims to be brought forward. This is, for example, in contrast to the USA, which has a different system for dealing with legal costs.[6]

TABLE 1: LITIGATION FUNDERS IN THE AUSTRALIAN MARKET[7]

Funder	Incorporated in
Argentum Investment Management Limited	United Kingdom
Bentham IMF Ltd *Listed on Australian Securities Exchange in 2000*	Australia
Bookarelli Pty Limited	Australia
BSL Litigation Partners Limited	Australia
Claims Funding Australia Pty Ltd	Australia
Comprehensive Legal Funding LLC	USA
CVC Litigation Funding Pty Ltd	Australia
Harbour Litigation Funding	United Kingdom
Hillcrest Litigation Services Ltd *Listed on Australian Securities Exchange in 1993*	Australia
International Justice Fund Limited	Australia
International Litigation Funding Partners Pte Ltd	Singapore
JustKapital Litigation Partners Limited	Australia
LCM Litigation Fund Pty Ltd	Australia
Legal Justice Pty Ltd	Australia
Litigation Lending Services Pty Ltd	Australia
Litman Holdings Pty Limited	Australia
Omni Bridgeway	The Netherlands

6 See Productivity Commission 2014, Access to Justice Arrangements, Inquiry Report No. 72, Chapter 18 for a more detailed examination of this issue.

7 Based on information available in Productivity Commission 2014, Access to Justice Arrangements, Inquiry Report No. 72, Canberra, and King & Wood Mallesons 2015.

THE PROBLEM

10. The problems being addressed by the Regulation concerned consumers' ability to access the justice system and potential conflicts of interest between litigation funders and their clients.

Access to the justice system

11. The problem of consumers' access to the justice system arose as a result of a succession of court decisions (outlined below and in detail at **Attachment A**). If not addressed, these decisions would have imposed a considerable additional regulatory burden on litigation funders, in turn raising the cost for consumers of pursuing court proceedings and potentially reducing their capacity to seek justice.

12. The outcome of *Brookfield Multiplex Ltd v International Litigation Funding Partners Pte Ltd* (Multiplex) in October 2009 was that litigation funding schemes and arrangements constituted managed investment schemes as defined by the Corporations Act. To continue to provide litigation funding schemes or arrangements, providers would have to meet registration, licensing, conduct and disclosure requirements.

13. The Multiplex decision brought litigation funding arrangements into the corporate regulatory net for the first time. Prior to this decision, funded litigation was not understood by regulators to be subject to regulation under the Corporations Act. The additional requirements of the Corporations Act may have resulted in some litigation firms leaving the market, dampening competition and/or raising the price at which litigation funding was offered, thus impacting on consumers' ability to access the justice system. The then Minister for Financial Services, Superannuation, and Corporate Law, the Hon Chris Bowen MP, noted that the decision in Multiplex effectively halted all existing class actions.[8]

14. Further, the outcome of *International Litigation Partners Pte Ltd v Chameleon Mining* (Chameleon) was that litigation funding agreements were a 'credit facility' within the meaning of reg 7.1.06 of the Corporations Regulations 2001. This decision raised questions as to whether litigation funders were also subject to the provisions of the *National Credit Code* and the *National Consumer Credit Protection Act 2009* (the Credit Act). This would have added another layer of regulatory requirements on litigation funders.

8 See media release by Chris Bowen, No.039, 4 May 2010.

15. The cost involved in litigation is known to be a prohibitive factor for many people seeking to right a civil wrong, resulting in situations where injustices prevail. An *Access to Justice Taskforce* in the Attorney-General's Department conducted a review which led to the Government's adoption of a Strategic Framework for Access to Justice in September 2009. The review recognised that a significant percentage (32.8 per cent) of the general population is unlikely to take any action when faced with a legal issue.[9] This could be due to factors such as a lack of knowledge, a lack of capacity, or feelings of disempowerment and exclusion.[10]

16. The taskforce also recognised that cost can be a significant barrier to justice. Individual consumers or investors may be under some degree of financial hardship, and the cost of legal representation together with the possibility of adverse cost orders may well inhibit people from bringing to court worthwhile cases. Litigation funders offer one means of overcoming this barrier to justice.

Conflict of interest

17. The court proceedings and subsequent consideration of regulatory responses drew to policymakers' attention the potential for conflicts of interest to arise from third party funding of court proceedings.

18. Such conflicts could arise because:

    - the funder has an interest in minimising the legal and administrative costs associated with the scheme and maximising their return;
    - lawyers have an interest in receiving fees and costs associated with the provision of legal services; and
    - the members have an interest in minimising the legal and administrative costs associated with the scheme, minimising the remuneration paid to the funder and maximising the amounts recovered from the defendant or insolvent company.

9 Attorney-General's Department, 2009, A Strategic Framework for Access to Justice in the Federal Civil Justice System, Report by the Access to Justice Taskforce, Attorney-General's Department, September 2009, page 55.

10 Attorney-General's Department, 2009, *A Strategic Framework for Access to Justice in the Federal Civil Justice System*, Report by the Access to Justice Taskforce, Attorney-General's Department, September 2009.

19. Conflicts of interests could affect, among other things:

- The recruitment of prospective members. For example, advertising calling for prospective members to participate in a litigation funding scheme may misrepresent the chances of success in order to maximise the number of participants.
- The terms of any funding agreement. For example, the funding agreement may allow the funder to make or participate in decisions affecting the litigation scheme, such as the decision to enter into alternative dispute resolution, settle or appeal.
- A scheme where there are difficulties with the case of the representative party, but not with the cases of the other members of the class. For example, the defendant may make an offer to a representative party with a weak case not to claim costs if the proceedings of the class are discontinued.
- Decisions to settle or discontinue the action. For example, a settlement offer may be received from the defendant before proceedings are issued which may be attractive to the funder whereas the lawyers may regard it as insufficient.[11]

11 Regulatory Guide 248: *Litigation schemes and proof of debt schemes: Managing conflicts of interest*, ASIC, April 2013.

THE OBJECTIVE

20. In response to the Multiplex and Chameleon decisions, the Government decided that it would act to reverse the effect of the court decisions by making regulations exempting litigation funding schemes and arrangements from relevant parts of the Corporations Act.

21. The main objective in enacting the Regulation was to ensure that third party litigation funders did not have to meet considerable additional regulatory requirements which could mean that consumers lost an important means of obtaining access to the justice system.

22. Given the inherent tension in litigation funding schemes between the interests of members, lawyers and funders[12], the Government deemed it necessary to require litigation funders to maintain and follow adequate practices for managing any conflict of interest.

12 13-085MR ASIC releases guidance on managing conflicts of interest in litigation schemes and proof of debt schemes, ASIC, April 2013.

INITIAL ACTIONS TAKEN

23. Following the court decisions, third party litigation funders were now subject to new regulatory requirements. Notionally, litigation funders could have approached ASIC individually seeking exemptions from aspects that may not be relevant to them, or they could have started the process to become compliant with the requirements. Either way, litigation funders were in an uncertain position, which had flow on effects for plaintiff firms and consumers.

ASIC class orders

24. Given the timing and sequencing of the court decisions, the Australian Securities and Investments Commission (ASIC) issued numerous class orders to allow class actions already underway to continue without potential disruption. ASIC's intention with the class orders was to provide relief pending the Government's decision on the regulatory framework for litigation funding.

25. In November 2009, ASIC granted transitional relief in relation to requirements under the Corporations Act to lawyers and litigation funders involved in legal proceedings structured as funded class actions that had commenced before 4 November 2009. Applications in respect of class actions to be commenced after that date were considered on a case-by-case basis.

26. This relief was extended in Class Order [CO 10/333] *Funded representative proceedings and funded proof of debt arrangements* which enabled the temporary operation of funded representative proceedings and funded proof of debt arrangements without compliance with the requirements of the Corporations Act. This relief was extended a further three times in Class Order CO 11/942, Class Order CO12/1301 and Class Order CO 13/19, to allow time for the commencement of the Regulation.

27. Class Order [CO 14/571] extends the relief in Class Order [CO 13/898] until 12 July 2016. This allows a lawyer or law firm providing a financial service in relation to a litigation scheme that is funded by a conditional costs agreement to operate without compliance within the requirements of Chapter 5C and Chapter 7 of the Corporations Act.

28. In 2013, ASIC granted new interim class order relief from the application of the Credit Act in Class Order CO 13/18. This was to address questions raised in the Chameleon case about litigation funding arrangements being considered credit facilities. The relief provided in CO 13/18 enabled the temporary operation of a litigation funding scheme without compliance with the requirements of the Credit Act and Code. This relief was extended in Class Order [CO14/569] until 12 July 2016.

29. ASIC extended CO 13/18 past its initial expiry date of July 2013 to allow the Government further time to implement regulations for the purposes of exempting litigation funding arrangements and proof of debt funding arrangements from the Credit Act.

30. ASIC's policy position is that in general, it will not use its discretionary powers to effect law reform. That is, relief will not be given to reverse the usual and intended effect of the Corporations Act (see: Regulatory Guide 51 Applications for relief at RG51.62). The temporary relief in this case was given for technical reasons arising out of the decision in Multiplex. There is no reason to believe that Parliament ever intended that litigation funding schemes should be regulated as a financial product under the Corporations Act.

31. ASIC granted relief as an interim measure until the Government settled its policy position because of the potential for significant disruption to current or contemplated funded proceedings.

32. Under the Legislative Instruments Act 2003, legislative instruments, such as ASIC class orders, are repealed automatically or 'sunset' after 10 years unless action is taken to exempt or preserve them. This might not provide the long term regulatory certainty that litigation funders and class action participates need in making a decision on whether to commence or fund proceedings.

POLICY OPTIONS CONSIDERED

33. Three main options were considered to address the issues raised by the court decisions (discussed below). The Government decided on *Option C.*[13]

Option A — Amending the definition

34. Under this option, the Government would make regulations clarifying that a litigation funding scheme or arrangement is not MIS as defined in the Corporations Act. No further regulatory action would be undertaken, which would in effect result in restoring the situation that existed prior to the Multiplex decision.

35. Option A, while imposing the lowest level of costs on stakeholders, could have left consumers exposed to certain risks, particularly in situations where litigation funders may experience some conflicts of interest. In addition, this option did not remove the uncertainty arising from the question of whether litigation funding arrangements satisfy the definition of financial products under Chapter 7 of the Corporations Act. This could, for example, lead to further court action similar to the Multiplex case, which could potentially cause further disruption to industry and consumers participating or intending to participate in class actions.

Option B — Imposing regulation as a financial product under Chapter 7 of the Corporations Act

36. Under this option, litigation funding would be defined as a financial product under Chapter 7 of the Corporations Act but, as in Option A, would not have to meet the specific MIS requirements in the Corporations Act. This would have regulatory consequences for persons providing defined services in relation to funded litigation, including the provision of advice and arranging for a consumer to participate in a class action or other funded litigation arrangement. This would include the licensing requirements, a range of general and specific conduct requirements, and the disclosure requirements applying to most financial products.

13 The Regulation does not address the issue of litigation funding arrangements being subject to the Credit Act and Code. This continues to be addressed by CO 14/569.

37. Option B would have provided a higher level of consumer protection than Option A but also would have imposed significant compliance costs and other regulatory burdens on industry. This could have been justified if there was clear evidence of significant consumer losses or other detriment suffered in class actions and litigation funding. It was not considered that such evidence had been provided through consultations conducted at the time. Rather, the submissions received tended to support the view that consumers were satisfied with the way class actions operated.

Option C — Providing exemptions from the MIS provisions and conditional exemptions from the Chapter 7 provisions

38. Under this option, persons providing services in relation to funded litigation would be given an exemption from the MIS provisions as well as a conditional exemption from the Chapter 7 financial product provisions in the Corporations Act. Consequently, none of the requirements of the Corporations Act relating to financial products (licensing, conduct, disclosure) would apply.

39. Under this option, the concerns about potential conflicts between the interests of class action law firms, litigation funders and the class action would be addressed by making the exemption from the Chapter 7 provisions conditional on appropriate arrangements being put in place to manage conflicts of interest.

40. The regulations would be complemented by a regulatory guide issued by ASIC outlining what would be considered appropriate arrangements for managing these conflicts.

41. The exemptions provided under this option would be applied to all funded litigation (that is, funded class actions as well as funded litigation with a single plaintiff).

42. This option would impose a minimal level of compliance costs on industry while addressing an important potential detriment to consumers by requiring litigation funders to manage their conflicts of interest. Option C was determined to be a more flexible approach which allowed the conditions applying to the Chapter 7 exemption to be adjusted in the future, if necessary, either through ASIC guidance or amending the proposed regulations.

Consultation prior to introduction of the Regulation

43. In evaluating the merits of imposing a specific regulatory regime for litigation funding arrangements, consultation was conducted with a wide range of stakeholders prior to the enactment of the pre-amended draft version of the Regulation (which was made prior to the findings of the Chameleon decision that a litigation funding arrangement was a credit facility).

44. The organisations consulted included all the main defendant and plaintiff lawyers, litigation funders, the Law Council of Australia, consumer organisations and academics with a special interest in this field.

45. Support for the introduction of a relatively detailed and extensive system of regulation for litigation funding arrangements, including as one possibility the MIS regime that would flow from the Multiplex decision, was limited to some defendants in class actions and their lawyers.

46. These parties argued that a range of consumer protection issues arise in relation to litigation funding arrangements that need to be addressed. Examples of such issues are lack of access by class action members to dispute resolution facilities, inadequate disclosure by litigation funders to potential members, potential conflicts between the interests of litigation funders and those of their clients, and potential exposure to financial risks if the litigation funder fails to satisfy its obligations.

47. These parties generally supported the Multiplex decision as one way of addressing the consumer protection issues raised.

48. Several of these stakeholders supported alternative regulation, for example, under the Chapter 7 regime if the Government was to act to reverse the effects of the Multiplex decision. The main argument put forward by these parties was that the consumer protection issues mentioned above exist independently of the Multiplex decision and would need to be addressed in some other way if regulation as a MIS was not supported.

49. One litigation funder argued strongly for regulation under Chapter 7 of the Corporations Act, requiring litigation funders to obtain an AFSL and be subject to the conduct and disclosure requirements in that chapter.

50. A small number of other stakeholders, including some academics with an interest in this area, argued that the current level of regulation in this area was inadequate and needed to be tightened.

51. Opposition to regulation under any extensive and relatively onerous regime was broad-based and included all defendant lawyers, most litigation funders, consumer organisations and some academics.

52. With respect to the Multiplex decision itself, these stakeholders held the view that the MIS regime was not conceived with class actions in mind and therefore does not operate in a meaningful way when it is applied to class actions.

53. Most of these stakeholders were of the view that heavy-handed regulation of any form was not necessary as there was little evidence at this stage of significant problems or consumer detriment in litigation funding arrangements.

54. Arguments were provided that substantial consumer protection arrangements are already in place for class actions under current court rules and regulations on the activities of lawyers, and that further heavy-handed regulation would be excessive.

55. One prominent consumer organisation active in the legal area noted that there was no evidence of consumers complaining in significant numbers about any losses or other detriment they had suffered in participating in funded litigation, and that imposing an unsuitable regulatory regime would be likely to impede access to justice avenues.

IMPACT ANALYSIS

56. This section considers the impacts of the Regulation on relevant stakeholder groups, and analyses performance against the objective. Treasury undertook targeted consultation with stakeholders to inform the impact analysis.

57. The Productivity Commission (the Commission) recently conducted a public inquiry into *Access to Justice Arrangements*, releasing its final report in December 2014.[14] Litigation funding was one issue among many examined by the inquiry, including current regulatory arrangements. Submissions were made from litigation funders, industry bodies, defendant and plaintiff lawyers and academia. Treasury was able to draw on submissions to this inquiry and the Commission's findings in the preparation of the PIR.

Performance against objectives

58. Based on the limited publicly available data on class actions and litigation funding arrangements, the Regulation appears to meet the objective of ensuring that consumers did not lose an important means of obtaining access to the justice system.

59. The number of new class actions filed in each of the last three years has been above the long-term average.

- In the 12 months to June 2015, 33 new class actions were filed in the Federal Court and the Supreme Courts of Victoria and NSW. For the 12 month period to June 2014, the number was 17 and in the 12 months to June 2013 the number was 18.[15] This compares to a total of 329 class actions filed in the 22 years from March 1992 to March 2014, at an average of around 15 per year.[16]

- In the two years to June 2015, there were 20 funded class actions out of the 50 class actions in that period (40 per cent).[17] This compares to 49 out of 329 class actions that received financial support from commercial litigation funders in the period from March 1992 to March 2014 (15 per cent).

60. There are many factors that determine whether parties decide to proceed with court action in addition to the availability of third party funding. Therefore, it is not possible

14 Productivity Commission 2014, *Access to Justice Arrangements*, Inquiry Report No. 72, Canberra.
15 King & Wood Mallesons 2014 and 2015, The Review: Class Actions in Australia 2013/14, and 2014/15.
16 Morabito, V. 2014, *Class Action Facts and Figures — Five Years Later*, November, Third Report, An Empirical Study Of Australia's Class Action Regimes, Monash University, Caulfield East, Victoria. This does not take account of matters that have been funded but not filed or never filed.
17 King & Wood Mallesons 2014 and 2015, The Review: Class Actions in Australia 2013/14, and 2014/15.

to draw a definitive conclusion on the number of class actions that would not have proceeded if the Regulation had not been introduced.

61. An increase in the number of litigation funding organisations participating in the Australian market (from 11 in 2013-14 to 17 in 2014-15[18]) also provides evidence that the Regulation has been effective in removing uncertainty about the regulatory requirements on litigation funders caused by the Multiplex and Chameleon court decisions.

62. Comments from industry organisations contacted by Treasury indicated that the Regulation has been effective in allowing the continued operation of third party litigation funders. One stakeholder said the Regulation had removed the uncertainty in regard to the appropriate regulatory requirements associated with litigation funding arrangements. Another stakeholder observed that there is no material impact on the conduct of litigation, implying that the Regulation has been effective in ensuring litigation funding remains an option to consumers.

63. However, concerns were raised with the consumer protection requirements of the Regulation.

64. On the one hand, some stakeholders considered additional regulation was required. These stakeholders asserted that ASIC's guidance[19] does not provide a mechanism to enforce the requirement to have procedures in place to address conflicts of interest. They also argued that, because of the complex relationships between litigation funders, lawyers and the client, the existing regulations were insufficient to deal with all potential conflicts of interests.

65. On the other, some stakeholders suggested that the new conflict of interest arrangements had not provided any additional benefit to consumers, as the existing arrangements to deal with conflicts of interest were providing sufficient protect. The requirements in the Regulation have hence duplicated pre-existing constraints on lawyers, and have unnecessarily increased the cost of litigation funding.

18 King & Wood Mallesons 2014 and 2015, The Review: Class Actions in Australia 2013/14, and 2014/15.

19 Regulatory Guide 248: *Litigation schemes and proof of debt schemes: Managing conflicts of interest*, ASIC, April 2013.

Compliance costs

66. The Regulation enabled the continuation of the status quo in regard to regulatory requirements for litigation funders under the Corporations Act, with the additional requirement that litigation funders have appropriate conflict of interest arrangements to protect consumers.

67. The benchmark for the calculation of compliance impact was the regulatory requirements that would have been imposed on third party litigation funders had the Regulation not be introduced. The compliance cost saving resulting from ASIC Class Order [CO 13/18] is not included in this calculation.[20]

68. The overall compliance impact for litigation funders can be broken down as follows:

    - the savings in compliance costs for litigation funders from not having to comply with the licencing and disclosure requirements applicable to MIS and financial product providers under the Corporations Act; and
    - an increase in compliance costs due to the requirement of having conflict of interest management arrangements in place.

69. In practice the only change in compliance burden is that associated with the conflict of interest management arrangements as third party litigation funders did not act to meet the requirements of the Corporations Act following Multiplex and Chameleon and prior to ASIC's class orders coming into effect.

70. In Treasury's targeted consultations, stakeholders were asked for information on compliance costs but did not specifically review the following calculations.

AFSL Costs

71. The Regulation exempts litigation funders from the requirement to hold an AFSL. The compliance cost avoided is made up of:

    - The initial cost of applying for an AFSL
    - The cost of maintaining an AFSL

72. Estimates of these two costs are added together and multiplied by the number of litigation funders active in Australia to reach an overall cost saving from the removal of the requirement for litigation funders to hold an AFSL.

20 The regulatory cost saving attributable to ASIC Class Order [CO 13/18] is estimated to be around $270,000 on an average annual basis.

73. This regulatory cost saving is estimated to be around $581,000 on an average annual basis.[21]

Product Disclosure Statement Costs

74. The Regulation exempts litigation funders from the definition of a MIS. One of the most significant costs associated with meeting the requirements for a MIS under the Corporations Act are the disclosure obligations under Chapter 7.

75. The cost of a Product Disclosure Statement (PDS) is made up of the initial cost of developing and producing a PDS and the ongoing costs of maintaining and updating the PDS.

76. Unlike with an AFSL, to satisfy the disclosure requirements under the Corporations Act, a PDS would have been required to be produced for each class action rather than for each litigation funding entity. Therefore, the estimated cost for each PDS is multiplied by the estimated number of actions each year to reach a total annual figure for PDS costs for all litigation funders.

77. This regulatory cost saving is estimated to be $1.4 million on an average annual basis.

Conflict of interest management arrangements costs

78. In addition to the cost savings discussed above, there is an increase in compliance cost due to the new requirement introduced by the Regulation regarding arrangements to manage conflicts of interest.

79. ASIC's Regulatory Guide 248: *Litigation schemes and proof of debt schemes: Managing conflicts of interest* states that a person who is providing, or has provided, a financial service to a litigation scheme must maintain and follow, for the duration of the scheme, adequate practices for managing any conflict of interest that may arise in relation to activities undertaken by a person in relation to the scheme or arrangement.

80. These arrangements are to apply to addressing potential, actual or perceived conflicts of interest.

81. In terms of compliance, the expectation is that the person providing financial services for litigation schemes takes responsibility for maintaining adequate procedures.

21 Under the Office of Best Practice Regulation guidelines, implementation costs and savings are averaged over a 10-year period.

82. In brief, to meet the obligation to maintain adequate practices and follow certain procedures to manage conflicts of interest, litigation funders must be able to show through documentation that:

- they have conducted a review of their business operations that relate to the litigation scheme to identify and assess potential conflicting interests;
- they have written procedures for identifying and managing conflicts of interest;
- they have effectively implemented the procedures;
- they regularly review the written procedures at intervals of not less than 12 months; and
- senior management or partners of the litigation firm oversee the implementation, monitoring and management of your procedures.

83. The obligation is scalable — that is, the amount of work involved to meet the obligation will vary depending on the nature, scale and complexity of the litigation scheme.

84. The estimated cost of maintaining adequate practices for managing any conflict of interest, including having certain specified written procedures, is $181,500 on an average annual basis.

Net regulatory cost impact for litigation funders

85. The net regulatory cost saving for litigation funders is estimated to be $1.8 million on an average annual basis (see Table 2).

TABLE 2: REGULATORY BURDEN AND COST OFFSET ESTIMATE TABLE

Average annual regulatory costs (from business as usual)				
Change in costs ($ million)	**Business**	**Community organisations**	**Individuals**	**Total change in costs**
Total, by sector	-$1.785	$0	$0	-$1.785
Cost offset ($ million)	**Business**	**Community organisations**	**Individuals**	**Total, by source**
Agency	$0	$0	$0	$0
Are all new costs offset? ☐ **Yes, costs are offset** ☐ **No, costs are not offset** ☒ **Deregulatory - no offsets required**				
Total (Change in costs – Cost offset) ($ million) = -$1.785				

CONCLUSION

86. The purpose of this post-implementation review is to assess the effectiveness of the Corporations Amendment Regulation 2012 (No 6) (the Regulation) that commenced on 12 July 2013. The regulation was introduced to address two problems, namely consumers' ability to access the justice system with the support of third party litigation funders and potential conflicts of interest between litigation funders and their clients. The effectiveness of the Regulation has been assessed in terms of how well it has addressed these problems.

87. Based on the available data and consultations with industry stakeholders, it appears that the Regulation has been successful in providing certainty that litigation funders are not subject to the provisions of the Corporations Act that impose registration, licensing, conduct and disclosure requirements. Third party litigation funders have continued to fund class actions in Australia and the number of litigation funders operating in the Australian market has increased.

88. In regard to the effectiveness of the conflict of interest provisions in the Regulation, stakeholders have divergent but generally unfavourable views. Some stakeholders consider the Regulation merely duplicates existing conflict of interest legislation and has not changed behaviour, while increasing compliance costs. Others have argued that the Regulation does not achieve its objective, in part because of inadequate powers given to ASIC to enforce the provisions.

89. A Productivity Commission inquiry on Access to Justice Arrangements, which reported in December 2014, examined a number of issues associated with private funding for litigation. Given the nature of this PIR, the merits of the recommendations from the Productivity Commission inquiry have not been considered.

COURT PROCEEDINGS

Litigation funding arrangements are managed investment schemes

1. In October 2009, the full Federal Court found that the funding arrangements in the matter of *Brookfield Multiplex Ltd v International Litigation Funding Partners Pte Ltd* (Multiplex)[22] constituted a managed investment scheme (MIS) as defined in the Corporations Act. Prior to Multiplex, funded litigation and class actions generally were not considered to be subject to regulation under the Corporations Act.

2. This appeal arose from an application by the appellants (Brookfield Multiplex) for a declaration that the litigation funding arrangements and solicitors' retainers constituted an unregistered MIS as defined in section 9 of the Corporations Act. Multiplex argued that the litigation funder supporting the representative proceedings was operating a 'managed investment scheme' as defined in s9 of the Corporations Act that was required to be, but had not been, registered.

3. Brookfield Multiplex sought declaratory and injunctive relief which would have had the effect of restraining the litigation funders, the solicitors and representative applicants in the proceedings from taking any steps pursuant to the litigation funding agreements and the solicitors' retainers; effectively stopping the proceedings.

Litigation funders require an Australian financial services licence (AFSL)

4. In the case of *International Litigation Partners Pte Ltd v Chameleon Mining* (Chameleon), the NSW Court of Appeal held that the funding agreement was a financial product as defined in the Corporations Act, requiring the funder to hold an Australian financial services licence (AFSL).

22 (2009) 180 FCR 11.

5. The appeal concerned the effect and classification of a litigation funding agreement between International Litigation Partners Pte Ltd (ILP) and Chameleon Mining NL (CHM). ILP had entered into an agreement to fund litigation commenced by CHM in the Federal Court. The agreement included an early termination clause that specified that when there was a change in control of CHM the agreement could be terminated subject to a fee being paid. In the absence of termination, ILP was entitled to a funding fee which consisted of a percentage of any sum awarded upon resolution of the Federal Court proceedings.

6. Subsequently there was a change in control in CHM. The new controlling company, Cape Lambert Resources, sought to rescind the agreement under section 925A of the Corporations Act based upon the assumption that the agreement was a financial product (a facility through which financial risk is managed) issued by a non-licensee (ILP was incorporated in Singapore and was not licensed to deal in financial products).

7. In dispute was whether ILP was entitled to the termination fee or the funding fee. This hinged on whether the agreement amounted to a financial product. The agreement could not be a financial product if it was an incidental component of another facility thats main purpose is not a financial product. A credit facility (being a provision of a form of financial accommodation for a period) is also not a financial product.

8. At trial[23], it was found that the funding agreement was not a financial product and therefore could not be rescinded. ILP was therefore entitled to the early termination fee, but not the funding fee.

9. ILP contested the second finding (seeking access to the funding fee also), CMH cross-appealed on the first question (seeking to rescind the agreement so as not to pay any fee), and ILP contested the cross-appeal on a matter of construction.
On appeal (by majority judgment, with one judge dissenting) it was held that although the agreement was validly rescinded (that is, the agreement was a financial product, being not incidental to the facility or a credit facility, and therefore the funder required an AFSL), and on proper construction of the agreement ILP was not entitled to the early termination fee.

Litigation funders are providers of credit

10. The Chameleon decision was appealed to the High Court by ILP.[24] ILP contested that it was entitled to the early termination fee. In order for this to be the case the agreement, ILP argued, was not a financial product.

23 Chameleon Mining NL v International Litigation Partners Pte Limited [2010] NSWSC 972.

11. The High Court considered whether the litigation funding agreement was a 'credit facility' within the meaning of reg 7.1.06 of the Corporations Regulations 2001 because a credit facility is specifically excluded from the definition of a 'financial product' under subparagraph 765A(1)(h)(i) of the Corporations Act. The High Court found that this particular agreement was not a financial product, but determined it was more akin to a credit facility. Therefore, ILP was entitled to the early termination fee.

12. This decision raised questions as to whether litigation funders were subject to provisions of the *National Credit Code* and the *National Consumer Credit Protection Act 2009*.

24 *International Litigation Partners Pte Ltd v Chameleon Mining NL (Receivers and Managers Appointed)* [2012] HCA 45.