
The regulation of conflicts of interest in Australian litigation funding

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Until recently, there was no formal regulatory scheme for litigation funders in Australia. In July 2013, Regulations were introduced to require funders to have “adequate practices” for managing any conflicts of interest that might arise in litigation they fund. Non-compliance attracts criminal sanctions and may invalidate funding agreements. The Regulations have been augmented with a detailed Regulatory Guide published by the Australian Securities and Investments Commission and represent the first national scheme to (at least partially) regulate litigation funding. The article discusses the new conflicts management regime and argues that it will improve funders’ practices, to the advantage of consumers of litigation funding. The Regulations also apply to entities that lawyers might establish to fund litigation in which they act, although the appropriateness of them doing so is currently being considered by the Federal Court. However, the Regulations are unlikely to be the last word in regulation with continued calls for mandatory licensing and prudential supervision of funders.

The Australian government has a famously “hands off” approach to the regulation of litigation funders. Australian funders face no mandatory licensing or prudential supervision. They are not regulated as credit providers.¹ Their personnel are not subject to vetting under a “fit and proper person” test. The government has provided funders with immediate and temporary relief from court decisions that would have otherwise imposed some regulatory oversight on the sector.²

In justifying its stance, the government has stressed the importance of litigation funding in improving access to justice, particularly for consumers.³ Government is also concerned to foster competition between funders by minimising barriers to entering the funding market. The generally responsible behaviour of Australia’s funders to date and the courts’ broadly supportive attitude towards funding have tempered the government’s attitude.

There is, however, one exception to this benevolence. Funders must now have “adequate practices for managing” any conflict of interest that may arise in litigation they fund. This requirement has been imposed by regulations.⁴ It is backed with criminal sanctions for non-compliance. The Australian Securities and Investments Commission (ASIC) has, via a Regulatory Guide on the Regulations, promoted the development of an extensive compliance regime for funders.

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¹ *International Litigation Partners Pte Ltd v Chameleon Mining NL (Receivers and Managers Appointed)* (2012) 246 CLR 455. The High Court held that the litigation funding arrangement in that case was a “credit facility”, raising the question of whether funders are subject to the provisions of the National Credit Code. This result has been reversed by the regulations referred to in n 4. However, as the *Corporations Act 2001* (Cth) excludes credit facilities from the definition of financial products (s 765A(i)(h)), the High Court’s decision had the further consequence that litigation funders do not need to hold an Australian Financial Services Licence.

² See Attrill WJ, “The Future of Litigation Funding in Australia” in Legg M (ed), *The Future of Dispute Resolution* (LexisNexis, 2013) pp 167, 176-178.

³ The Hon Chris Bowen MP (Minister for Financial Services, Superannuation and Corporate Law), “Government Acts to Ensure Access to Justice for Class Action Member” (speech delivered at *IMF (Australia) Ltd Shareholder Class Action Conference*, Quay Grand Suites, Sydney, 4 May 2010).

⁴ *Corporations Amendment Regulation 2012 (No 6)*, as subsequently amended by the *Corporations Amendment Regulation 2012 (No 6) Amendment Regulation 2012 (No 1)*.



This article discusses the new Conflicts Rules. It considers their practical application to litigation funders operating in Australia and speculates on their potential extension to lawyers as funders (should a recent application to permit a law firm to provide funding, through a separate entity, to claimants in a class action in which the law firm is acting is successful). Finally, it briefly comments on the new laws' effectiveness in protecting the public interest.

BACKGROUND TO THE CONFLICTS RULES

The government's light-handed regulation of funders was heralded in a speech given by the Minister, the Hon Chris Bowen, on 4 May 2010.⁵ The government, he declared, had decided not to impose a "heavy compliance burden" on funded class actions in particular. The government would reverse the Full Federal Court's decision in *Brookfield Multiplex Ltd v International Litigation Partners Pte Ltd* (2009) 180 FCR 11, which had found the funded class action in that case to be an unregistered (and therefore unlawful) managed investment scheme.

The Minister noted that class actions were already subject to extensive regulation under federal and State legislation. They were also closely supervised by the court. He continued:

No evidence has been provided to indicate that consumer rights are being breached under the current class actions regulatory framework or that consumers are suffering losses or other detriments as a result of participating in class actions. As such, the Government considers that imposing a significant regulatory burden cannot be justified in these circumstances.

While the Government will not be imposing a heavy regulatory burden; in order to ensure that the interests of class members are held as paramount, it is considering regulation to manage potential conflicts of interest through guidance issued by ASIC.⁶

Critics of litigation funding have long argued that the activity is rife with conflicts between the interests of the funder, the funded claimants and the lawyers. These, they say, call for explicit regulation or court intervention to protect claimants.⁷ For their part, funders point to the strong alignment between their interests and those of the claimants they fund, as both seek to maximise the returns from the litigation. Litigation funding agreements already contain provisions dealing with potential conflicts,⁸ and there is little empirical evidence of conflicts causing detriment to consumers of litigation funding.⁹ However, in deciding to single out conflicts management for regulation, the government has been persuaded by the critics.

THE REGULATIONS

The scope of the Regulations

The Conflicts Rules are imposed by the *Corporations Amendment Regulation 2012 (No 6)*, which commenced on 12 July 2013. The Regulations:

1. apply to single-party ("litigation funding arrangements") and multiparty ("litigation funding schemes") funded proceedings, with the latter encompassing litigation by an insolvent company's administrator that is funded by the company's creditors or shareholders ("proof of debt schemes");
2. exempt litigation funding arrangements and schemes from the definition of "managed investment scheme" in the *Corporations Act 2001* (Cth);

⁵ Bowen, n 3.

⁶ Bowen, n 3.

⁷ See eg Legg M, *Litigation Funding in Australia – Identifying and Addressing Conflicts of Interest for Lawyers* (US Chamber Institute for Legal Reform, 2012) p 33.

⁸ Attrill W, *Ethical Issues in Litigation Funding* (IMF (Australia) Ltd, 2009).

⁹ Law Council of Australia, *Guidelines on Managing Conflicts of Interest in Litigation Schemes and Proof of Debt Schemes* (submission to the Australian Securities and Investments Commission, 21 September 2012) at [7] ("substantial risks involving funded litigation have not yet emerged"), [49] ("the recruitment of members to join litigation schemes has not been an area of significant concern to date").



3. declare interests in litigation funding arrangements and schemes to be financial products (and therefore subject to licensing under the Corporations Act);
4. exempt a person who is providing, or has provided, services in relation to a litigation funding arrangement or scheme from the need to hold an Australian Financial Services Licence (AFSL), provided the person maintains “for the duration of the litigation funding scheme or arrangement, adequate practices for managing any conflict of interest that may arise in relation to activities undertaken by the person, or an agent of the person, in relation to the scheme or arrangement”; and
5. declare that neither a litigation funding arrangement nor a litigation funding scheme is a credit facility (thereby exempting complying funders from the need to observe the National Credit Code).

The Regulations’ requirements

Regulation 7.6.01AB(4) specifies that a funder has adequate practices for managing conflicts of interest in relation to a litigation funding arrangement or scheme if the funder can show the following “through documentation”:

- a) the funder has conducted a review of the funder’s business operations that relate to the scheme or arrangement to identify and assess potential conflicting interests;
- b) the funder:
 - i) has written procedures for identifying and managing conflicts of interest; and
 - ii) has implemented the procedures;
- c) the written procedures are reviewed at intervals no greater than 12 months;
- d) the written procedures include procedures about the following:
 - i) monitoring the funder’s operations to identify potential conflicting interests;
 - ii) how to disclose conflicts of interest to general members and prospective general members;¹⁰
 - iii) managing situations in which interests may conflict;
 - iv) protecting the interests of general members and prospective general members;
 - v) how to deal with situations in which a lawyer acts for both the funder and general members;
 - vi) how to deal with a situation in which there is a pre-existing relationship between any of a funder, a lawyer and a general member;
 - vii) reviewing the terms of a funding agreement to ensure the terms are consistent with Div 2 of Pt 2 of the *Australian Securities and Investments Commission Act 2001* (Cth) (ASIC Act); and
 - viii) recruiting prospective general members;
- e) the terms of the funding agreement are reviewed to ensure the terms are consistent with Div 2 of Pt 2 of the ASIC Act; and
- f) the matters mentioned in paragraphs (a) to (e) are implemented, monitored and managed by:
 - i) if the funder is an entity other than an individual – the senior management or partners of the funder; or
 - ii) if the person responsible for providing the financial service is an individual that represents a funding entity – the senior management or partners of the entity.

ASIC’S REGULATORY GUIDE

ASIC has put (rather a lot of) flesh on the bones of the regulations with its Regulatory Guide 248 – “Litigation Schemes and Proof of Debt Schemes: Managing Conflicts of Interest” released in April 2013.¹¹

¹⁰ The Regulations and ASIC use the term “member” or “general member” to refer to any litigant who joins a litigation funding arrangement or scheme; in this article such litigants are also referred to as “claimants”.

¹¹ Australian Securities and Investments Commission, *Litigation Schemes and Proof of Debt Schemes: Managing Conflicts of Interest* (Regulatory Guide 248, 2013) (RG 248).



The Guide sets out ASIC's expectations of how funders will comply with the Regulations, while emphasising that each funder who relies on the exemptions afforded by the Regulations ultimately remains responsible for determining its own arrangements to manage any interests that may conflict.¹²

The Guide reflects its origins in a Consultation Paper¹³ issued by ASIC in relation to an earlier version of the Regulations¹⁴ that limited the exemptions to funders of multiparty litigation. The Regulations have superseded the earlier set. As a result, funders of single-party litigation need in some cases to extrapolate from the guidance provided by ASIC when seeking to tailor the recommended compliance regime to single-party cases.

What is a conflict?

ASIC considers that conflicts may arise in a litigation scheme¹⁵ as a result of the *divergence of interests* between the funder, lawyers and claimants:

The nature of arrangements between parties involved in a litigation scheme or a proof of debt scheme has the potential to lead to a divergence between the interests of the members and the interests of the funder and lawyers because:

- (a) the funder has an interest in minimising the legal and administrative costs associated with the scheme and maximising their return;
- (b) lawyers have an interest in receiving fees and costs associated with the provision of legal services; and
- (c) 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.

The divergence of interests may result in conflicts between the interests of the funder, lawyers and members. These conflicts of interest can be actual or potential, and present or future.¹⁶

So, for example, ASIC suggests that potential conflicts could arise if the lawyers are retained to act for both the funder and the claimants (members). There may be a pre-existing legal or commercial relationship between the funder, lawyers or claimants that might affect the independence of any of those parties from the others and so lead to conflicts of interest.¹⁷

Another situation cited by ASIC arises out of the well-established right of a funder to exercise a degree of control over the conduct of the proceedings.¹⁸ ASIC gives an example that, "in an effort to reduce legal costs, the funder may recommend to the lawyer that [only] certain causes of action should be pleaded" out of a wider range of potential claims.

As an aside, while a conflict (in the sense of a disagreement) might arise if the lawyers or the claimant wished to plead more causes of action than the funder was willing to fund, it is difficult to see how the claimant's interests could be detrimentally affected by a funder's insistence that only the most promising causes of action be run in the interests of minimising the costs and risks of the proceedings and maximising their potential outcome.

¹² RG 248.11-12.

¹³ Australian Securities and Investments Commission, *Litigation Schemes and Proof of Debt Schemes: Managing Conflicts of Interest* (Consultation Paper 185, 2012).

¹⁴ Confusingly also called the *Corporations Amendment Regulation 2012 (No 6)*. See Attrill, n 2, pp 177-178. The original set of Regulations was amended to take account of the High Court's decision in *International Litigation Partners Pte Ltd v Chameleon Mining NL (Receivers and Managers Appointed)* (2012) 246 CLR 455.

¹⁵ "Litigation scheme" refers to both litigation funding arrangements and litigation funding schemes.

¹⁶ RG 248.11.

¹⁷ RG 248.13.

¹⁸ RG 248.13. ASIC accepts that "it is appropriate for the funder to give instructions to the lawyers and for the lawyers to consider these instructions in the light of their obligations to the members": RG 248.79.



ASIC notes that potential conflicts could affect different aspects of a litigation funding scheme, such as the “recruitment” of prospective group members to a class action.¹⁹ Thus the funder’s or lawyers’ advertisements for a proposed action might overemphasise the litigation’s prospects of success in order to maximise the sign-up.

Again, it is difficult to envisage the claimants suffering a detriment in these circumstances if the proposed litigation scheme is the only practical option by which the claimants can prosecute their claims and recover their loss. But it is possible that where more than one prospective litigation scheme is being presented to claimants whose claims arise out of the same circumstances, a more balanced advertisement might have led some claimants to decide to join the competing scheme. One could expect the competing funders in this situation to closely monitor each other’s promotional material.

The terms of the funding agreement may give rise to divergent interests, which will need to be managed.²⁰ ASIC cites the example of the funder’s commission being higher if proceedings are not commenced within a year of the agreement’s signing, potentially giving the funder an incentive to delay the start of the litigation.

There may also be conflicts within the claimant group itself, eg if the representative’s case is weaker (or stronger) than the claims of the group members. ASIC is particularly concerned with conflicts that may arise over decisions to settle or discontinue the funded litigation.²¹ A settlement offer may be “attractive to the funder due to the size of the global resolution sum” but “the lawyers may regard the damages payable to the majority of the class as insufficient”.

How should conflicts be managed?

ASIC’s cardinal objective is that funders “have robust arrangements for addressing potential, actual or perceived conflicts of interest” that may arise in a litigation scheme or a proof of debt scheme so as to adequately “protect the interests of members [ie claimants]” and that funders follow those arrangements from the time they begin to recruit prospective members to the scheme until all members have ceased to have an interest in the scheme.²²

As noted, ASIC avoids providing an exhaustive guidance. It notes that funders are “best placed to know [their] own interests and where conflicts may arise” in the course of their business.²³ Having said that, ASIC goes on to provide detailed suggestions on how funders might meet ASIC’s expectations for complying with the regulations.

The key elements of ASIC’s approach are set out below.

Review by each funder of its business and identification of conflicts

The starting point for compliance is for the funder to show, through documentation, that it has “conducted a review of [its] business operations that relate to [each] litigation scheme or proof of debt scheme to identify and assess potential conflicting interests”.²⁴

Formulation and adoption of a conflicts management policy

Funders must be able to demonstrate²⁵ that they have written procedures to:

- a) identify divergent interests and where conflicts may arise;
- b) assess those interests and potential conflicts; and
- c) decide upon and implement an appropriate response to those divergent interests and potential conflicts.

¹⁹ RG 248.14.

²⁰ RG 248.14.

²¹ RG 248.14.

²² RG 248.18-21.

²³ RG 248.23, 25.

²⁴ RG 248, s B, Key Points.

²⁵ RG 248.28.



Funders must effectively implement the procedures, which need to be designed “according to the nature, scale and complexity” of the litigation schemes they fund. ASIC again emphasises that “the procedures [each funder should] adopt should be designed with your own particular circumstances in mind”.²⁶ The obligations are scalable (ie a large class action may require more extensive or detailed procedures than a small, single-party litigation scheme). More than this, ASIC expects the procedures to become embedded within each funder’s culture and to form an integral part of the funder’s management of each litigation scheme.²⁷

Senior management oversight of the policy

Regulation 7.6.01AB(4)(f) requires a funder’s senior management to take responsibility for implementing, monitoring and managing the funder’s conflicts management procedures. According to ASIC, the funder should appoint a senior person with ready access to the board or partnership of the funder. This person is to be assigned a number of important tasks, including ensuring the funder devotes adequate staff and resources to undertake the required compliance functions.²⁸

Regular review and updating of the policy

ASIC expects funders to continue to monitor, assess and evaluate divergent interests throughout the life of each litigation scheme as well as to monitor, assess and evaluate whether the funder’s written procedures remain adequate to address, and minimise, the impact of those divergent interests. In addition to ongoing case-by-case review, each funder’s procedures must be reviewed on at least an annual basis.²⁹

Disclosure of conflicts

Disclosure forms a critical component of ASIC’s compliance guidance:

We expect that you will make full and appropriate disclosure to members and prospective members as part of your procedures to manage interests that may conflict. While disclosure alone will sometimes not be enough, it is a key mechanism that you should use to manage potential and actual conflicts of interest.³⁰

The purpose of disclosure is to provide claimants with sufficient information about the situations in which conflicts may arise to enable them to understand the different interests of the funder, lawyers and themselves. Disclosure will also inform them of the procedures (including dispute resolution procedures) available to manage those conflicts so as to adequately protect their interests. Disclosure should ideally be made prior to the commencement of the litigation scheme so that prospective members can make an informed choice about whether to join the scheme or not.³¹

Disclosure may be in writing or verbal, and if the latter “appropriate records of the disclosure should be retained”.³² Disclosure should be “specific” and “meaningful for members” and contain enough information of the particular circumstances of the scheme for members to be able to understand the potential impact of any divergent interests. Disclosures can be delivered electronically to members, provided their consent to this method of communication has first been obtained.³³

Recruiting claimants

Regulation 7.6.10AB(4)(d)(viii) refers specifically to the need for procedures that funders should follow in recruiting prospective claimants, eg to join a proposed funded class action. ASIC is concerned that conflicts may arise in this area because of the commercial importance, to the funder, of

²⁶ RG 248.31.

²⁷ RG 248.32, 40.

²⁸ RG 248.45, 47.

²⁹ RG 248.29, 43; reg 7.6.01AB(4)(c).

³⁰ RG 248.51.

³¹ RG 248.52, 54.

³² RG 248.57.

³³ RG 248.61, 63.



recruiting claimants with good claims to the scheme and the risk that the funder might engage in misleading or deceptive conduct to increase the “sign-up”.³⁴

The senior manager with responsibility for the funder’s conflicts management procedures should also have responsibility to oversee any recruitment process. The conflicts procedures are to include arrangements to ensure that any advertising or promotional material does not mislead prospective members about “significant features, risks or returns”.³⁵ These features might include the likely net return to claimants after expected costs and fees have been deducted. Claimants should also not be told that their only avenue to recover compensation is through the proposed action if other options in fact exist.

Review and amendment of funding agreement terms

The funding agreement is central to the constitution and operation of a litigation scheme. Regulation 7.6.01AB(4)(e) requires funders to review their funding agreements for compliance with Div 2 of Pt 2 of the ASIC Act, which enacts laws dealing with unfair contracts, unconscionable conduct and consumer protection.³⁶

ASIC goes further and sets out a number of provisions that it expects funders to include in their funding agreements.³⁷ Many of these provisions are already common in Australian funding agreements (such as cooling-off periods, an obligation for the lawyers to give priority to claimants’ instructions over those given by the funder etc), but some are new.

The most important of these, from a funder’s perspective, is that the agreements include an obligation on the funder to comply with the Regulations, to provide “timely and clear disclosure to members of any breach” of the Regulations and to allow claimants to terminate their funding agreement if the funder breaches the Regulations.

Amendments are also suggested in relation to the procedure to be applied to settlements, as discussed below.

Primacy of the lawyers’ obligations to the claimants

Regulation 7.6.01AB(4)(d)(v) mandates that a funder’s procedures should deal explicitly with situations in which the lawyer acts for both the funder and the claimants.

It is unusual for a funder to enter into a retainer agreement with the lawyers on the basis either that the funder is the lawyers’ sole client (ie the claimants themselves have no retainer with the lawyers) or that the funder and the claimants are both clients of the lawyers. ASIC’s preference is that the lawyers act solely for the claimants.³⁸ This largely accords with current market practice.

Independence of the funder, lawyers and claimants

Regulation 7.6.01AB(4)(d)(vi) requires procedures to manage situations in which there is a “pre-existing relationship” between the funder, the lawyers, the claimants or any of them.

In a market the size of Australia, where a relatively small number of funders and plaintiff law firms dominate the provision of funded actions (particularly in multiparty litigation), it is inevitable that a funder may have previously funded litigation with a firm of lawyers who now seek funding, from that funder, for a new case. The funder may also be funding other litigation currently being conducted by that law firm.

ASIC recognises these commercial realities by expecting either that funders, lawyers and claimants in a litigation scheme will be independent of each other (which is ASIC’s preference) or, if

³⁴ RG 248.66.

³⁵ RG 248.65, 67.

³⁶ *Virginia Nemeth (by her tutor) v Australian Litigation Funders Pty Ltd* [2013] NSWSC 529 (challenge to litigation funding agreement under the *Contracts Review Act 1980* (NSW), unconscionability at general law and under the *Trades Practices Act 1974* (Cth) or the *Australian Securities and Investments Commission Act 2001* (Cth) and the *Fair Trading Act 1987* (NSW) rejected).

³⁷ RG 248.71.

³⁸ RG 248.79.



not, that any relevant relationship will be disclosed to the claimants. ASIC is particularly concerned that claimants are told whether any of the people or their relatives who comprise the funder and the lawyers are “associates” (in the sense that term is used in the Corporations Act) and are informed about any direct or indirect fee or benefit that is to be paid or given by one party to the litigation scheme to another party.³⁹

Critics of funding argue that prior relationships between funders and lawyers, and the lawyers’ hope of obtaining further work in the future from funders, may undermine lawyers’ performance of their duties to claimants in funded litigation. However, funders and lawyers in Australia have historically operated on an arms-length basis, not least because of statutory prohibitions on lawyers charging contingency fees. Conflicts that might have arisen where the lawyers either controlled the funder (or vice versa) or were effectively funding litigation they were also conducting, have not yet arisen.

That may be about to change, as discussed below. Interestingly, and perhaps in anticipation of such a development occurring, in a rather understated note to RG 248.83, ASIC observes:

If a lawyer is a partner of a law firm that is acting for members in a litigation scheme and a director of the funder providing the funding for the same litigation scheme, it should be disclosed.

Independent review of settlements

Settlement has long been identified as a potential conflict “hot spot” given the risk that funders (or lawyers or representatives) might seek to force a settlement on the claimants in order to advance the funders’, lawyers’, or representatives’ own interests. Of course, if the proceedings have commenced as a class action then court approval of the settlement will also be required, which ameliorates the risk of conflicts harming the claimants considerably. But reg 7.6.01AB(4)(d)(iii) requires funders’ procedures to explicitly manage conflicts, which includes any that might arise in the settlement of funded claims.

IMF’s litigation funding agreements seek to deal with conflicts over settlement by providing for disputes between funders and claimants (or, in class actions, representatives) to be resolved by means of a binding opinion given by the most senior counsel retained by the lawyers in the matter. This approach has been adopted by other Australian funders.

ASIC approves of this approach and takes it further. ASIC sets out a list of criteria that it considers counsel should take into account in deciding whether any proposed settlement agreement is fair and reasonable.⁴⁰ The criteria are set out at App 1 to this article and are evidently drafted with funded multiparty proceedings in mind. They require modification if they are to be applied to single-party litigation.

Counsel is to approve not only settlements in cases where proceedings have commenced but also (crucially, in ASIC’s view) in cases where proceedings have not commenced in which the safety-valve of court approval will not be available.⁴¹

Dispute resolution procedures

Any conflicts management regime needs to have fair, transparent and independent processes for resolving disputes that may arise between the parties to a litigation scheme. ASIC requires the funding agreement to disclose how disputes in relation to the litigation scheme will be resolved.⁴² Some of these procedures have been referred to above. In some cases, the funder may be a member of an independent dispute resolution scheme, such as the Financial Ombudsman Service. Alternatively, the funding agreement may incorporate other third party dispute resolution options, such as mediation or arbitration under the rules of the Australian Centre for International Commercial Arbitration.

³⁹ RG 248.81, 83.

⁴⁰ RG 248.94-98.

⁴¹ RG 248.91.

⁴² RG 248.71(f).



Record-keeping by funders

Funders must keep, for at least seven years, extensive written records of their compliance with the Regulations. This will provide ASIC with a paper trail (and the funder with a documented defence) should ASIC decide to take regulatory action against a funder. The records should include:

- a) conflicts identified and action taken;
- b) any reports given to the funder's owners, governing body or senior management about conflicts of interest matters; and
- c) copies of written disclosures made to prospective members of litigation schemes or the public as a whole.⁴³

Does the conflicts regime apply to lawyers?

The Regulations apply to any person who is providing or has provided a financial service covered by the exemptions in regs 7.6.01(1)(x) or (y) – ie a service in relation to a litigation funding scheme or litigation funding arrangement.

In the consultation conducted by ASIC on an earlier version of the Regulations, submissions were made that the conflicts regime should only apply to third party funders and not to lawyers.⁴⁴ ASIC was adamant that its guidance should apply to any person, including lawyers, who relies on the exemptions or who conducts funding activities under an AFSL.⁴⁵ But as ASIC notes in the Regulatory Guide, many activities undertaken by lawyers in litigation schemes or arrangements will not be financial services or are likely to be exempt from the requirements of Ch 7 of the Corporations Act. Lawyers therefore generally do not need to rely on the exemptions provided by the Regulations.⁴⁶ The full extent of the Regulations' coverage of lawyers involved in funded litigation may one day be tested in the courts. However, there is one potential area where there is no question that lawyers will need to comply with the conflicts regime. That will arise if lawyers set up litigation funding businesses of their own.

As noted above, lawyers and funders have traditionally interacted on an arm's-length basis, with each party being owned independently of the other. The development of standalone third party funders in Australia was due, in part, to the longstanding prohibition on Australian lawyers charging contingency fees (ie fees calculated as a percentage of their client's recovery). That restriction does not apply to litigation funders that are not constituted as law firms.⁴⁷

Until recently, no law firm had sought to incorporate its own funding company to fund litigation to be conducted by the firm. The Law Council of Australia, in a submission on litigation funding regulation to the Standing Committee of Attorneys-General in 2006, called the establishment of a captive funder by a law firm a "theoretical possibility" only:

⁴³ RG 248.36.

⁴⁴ See eg the submission made by the Australian Institute of Company Directors (21 September 2012) p 4: "The purpose of the Regulations was to ensure that litigation funders had appropriate conflicts of interest arrangements in place. One of the reasons for this was because litigation funders are not subject to the same professional and ethical obligations as lawyers."

⁴⁵ Australian Securities and Investments Commission, *Response to Submissions on CP 185 Litigation Schemes and Proof of Debt Schemes: Managing Conflicts of Interest* (Report 138, 2013) p 10.

⁴⁶ RG 248.9, referring to s 766B(5)(a) of the *Corporations Act 2001* (Cth) (advice given by a lawyer in his or her professional capacity, about matters of law, legal interpretation or the application of the law to any facts is not financial product advice). Under reg 7.6.01(e) of the *Corporations Regulations 2001* (Cth), ASIC considers that merely referring a claimholder to a litigation funder would not constitute providing a financial service.

⁴⁷ Legg M, *Case Management and Complex Civil Litigation* (Federation Press, 2011) pp 232-233. The Australian Law Reform Commission recommended that representatives in class actions be allowed to enter into contingency fee arrangements with lawyers representing the class. This recommendation, and another that a public fund be established to provide financial assistance to representatives, were not adopted by the Commonwealth government when Pt IVA of the *Federal Court of Australia Act 1976* (Cth) was enacted in March 1992: Morabito V, "Federal Class Actions, Contingency Fees, and the Rules Governing Litigation Costs" (1995) 21 *Monash University Law Review* 231 at 234.



The Law Council is not aware of any example of a law practice which has done so and, indeed, the Law Council is advised that this is because a law firm would be unable to do so without offending the statutory rules governing the engagement by lawyers in non-legal services.⁴⁸

Lawyers may have been inhibited by a concern that self-funding might be interpreted as an attempt to circumvent the statutory prohibition on contingency fees.⁴⁹ Conflicts issues also come to the fore. The US Chamber Institute for Legal Reform, admittedly no fan of litigation funding, commented to ASIC on law firm-owned funders in these terms:

[W]here a lawyer is both a lawyer and owner or controller of the litigation funding vehicle this may create a further level of conflicts of interest. For example, the funder may accept lucrative charge-out rates for the lawyer knowing that in a successful litigation scheme the legal fees will ultimately be borne by the members and/or the defendant in the litigation. There is no incentive to minimise legal fees. Of course, if the litigation is unsuccessful the funder pays the legal fees, but this is really the lawyer being obligated to pay themselves. Conflicts of interest are best managed if lawyers and funders are independent of each other.⁵⁰

Whatever the reasons for past reticence, the major class action law firm Maurice Blackburn has recently applied to the Federal Court for approval for a litigation funder associated with the firm, Claims Funding Australia Pty Ltd (CFA), to part-fund a class action being run by Maurice Blackburn.⁵¹ CFA is the trustee of a discretionary trust, the Claims Funding Australia Trust. Maurice Blackburn's Chairman is a director of CFA, its CEO and a senior partner are shareholders of CFA and the firm's principals are beneficiaries of the trust.

CFA's application is presently before the Federal Court. It is reported that the Legal Services Commissioners of New South Wales, Queensland and Victoria have written a joint submission to the court raising concerns over CFA's proposed funding arrangement with Maurice Blackburn. Maurice Blackburn is satisfied that CFA has been set up in such a way as to ensure its independence from the law firm and that it complies with ASIC's requirements for conflicts management.⁵²

If the application is granted, it will have important implications for the Australian legal services and litigation funding markets. It may precipitate a review (and possible overturning) of the rules against lawyers charging contingency fees. Alternatively, it could lead to a tightening of lawyers' professional obligations and a clear, regulated demarcation between the roles played by funders and by lawyers in funded litigation. The point has been made in the American context, where contingency fee charging by lawyers is long-established but third party funding is becoming more available, that:

One could argue that the difficulty of an attorney's maintaining professional objectivity is greater where his own money is at stake than when a third party is funding the litigation. Viewed in that light, third-party funding actually offers a safeguard against impermissible attorney bias because it puts financial concerns at one step removed.⁵³

⁴⁸ Law Council of Australia, *Litigation Funding* (submission to the Standing Committee of Attorneys-General, 14 September 2006) at [97]-[98].

⁴⁹ Council of Australian Governments, *National Legal Profession Reform – Discussion Paper: Legal Costs* (4 November 2009) p 11: "In several jurisdictions [legal] practitioners are prohibited from entering into contingency agreements in claims for damages. Generally, practitioners should not be able to avoid these prohibitions by taking a financial interest in a litigation-funder or by their associate or relative taking an interest. Accordingly, the Taskforce notes that legal practitioners could be prohibited from establishing corporate vehicles to provide litigation funding or entering into agreements with litigation funding vehicles owned by an associate of their law practice or a relative."

⁵⁰ US Chamber Institute for Legal Reform, *Australian Securities and Investments Commission Consultation Paper 185: Litigation Schemes and Proof of Debt Schemes: Managing Conflicts of Interest* (submission to ASIC) p 14.

⁵¹ The application has been made by CFA as trustee of the Claims Funding Australia Trust in *Clasul Pty Ltd v Commonwealth of Australia* (NSD 630/2013) in the Federal Court in Sydney.

⁵² Boxsell A, "ASIC Warns on Ties Binding Law Firms, Litigation Funders", *The Australian Financial Review* (26 April 2013) p 35.

⁵³ Lyon J, "Revolution in Progress: Third-Party Funding of American Litigation" (2010) 58 *UCLA Law Review* 571 at 607.



HOW DO THE REGULATIONS IMPACT ON FUNDERS?

The Regulations impact funders in a number of ways. For the first time, all funders operating in Australia are subject to a common set of rules. Previously, only those funders that operated under an AFSL were required to maintain adequate procedures for managing conflicts of interest. This obligation is now universal.

Funders are required to not only adopt and implement a conflicts policy, but also to review it on a regular basis. This requirement will increase the focus funders bring to bear on identifying and managing conflicts of interest that might arise in their funded cases. It is likely to improve funders' (and, by extension, lawyers') practices across the market in this regard.

Funders' disclosures to clients of actual or potential conflicts can be expected to become more fulsome, considered and specific than would have been the case without the Regulations. This should allow existing and prospective clients of a funder to be better informed about the funded litigation, its risks and their rights in relation to it, and the respective roles of the funder, the lawyers and any representative – at least for those clients who are sufficiently motivated to take the time to read the disclosures. Funders' clients will benefit from ASIC's insistence on fair and reasonable settlements and transparent and independent dispute resolution procedures.

The extensive record-keeping and senior management oversight obligations imposed on funders will enhance ASIC's ability to police compliance with the Regulations. ASIC's guidance has introduced new measures designed to improve the position of claimants in settlements of multiparty-funded claims, including where proceedings have not been commenced and any settlement would not automatically be subject to court approval. But the important question is whether the Regulations offer adequate protection to consumers of litigation funding in Australia.

DO THE REGULATIONS GO FAR ENOUGH?

The universal reaction to the Regulations, from funders, lawyers, academics, industry bodies and other defendant groups, is that they do not go far enough.⁵⁴

The reason was given above: there remains no restriction on an under-capitalised funder setting-up shop in Australia, agreeing to fund litigation here but being unable to meet its financial commitments when they fall due. Security for costs orders offer some protection to defendants, but are an imperfect substitute for full licensing and prudential supervision of funders. The concern is particularly acute in relation to foreign funders operating in Australia.

One question of some importance to funders is what might the new Coalition government's attitude be towards the industry? The Coalition's legal affairs spokesman and now Attorney-General in the new government, Senator George Brandis QC, is reported as favouring a review of the regulation of funders to examine whether they should continue to be exempt from mandatory licensing and whether largely unregulated litigation funding encourages "opportunistic" class actions.⁵⁵ Further developments in the regulation of litigation funders in Australia can be expected.

⁵⁴ One example among many is the Law Council's submission to ASIC on the Regulations (n 9) at [7]: "The Law Council wishes to make it clear that it has advised the Commonwealth Treasury that it would be a better approach to simply require litigation funders to hold an Australian Financial Services Licence (AFSL), subject to appropriate conditions. This would establish a formal reporting framework regarding conflicts of interest, which would be preferable to the approach currently proposed. While substantial risks involving funded litigation have not yet emerged, the Law Council considers that the AFSL regime would offer greater certainty, reduce the potential for collateral attacks on funded litigation while, at the same time, enhancing consumer protection."

⁵⁵ Merritt C, "Brandis Takes Aim at Litigation Funders", *The Australian* (19 July 2013) p 25.



APPENDIX 1**Criteria for senior counsel to apply in approving a settlement (ASIC RG 248.94-98)**

RG Ref	
248.94	In reviewing a settlement agreement, counsel (or senior counsel if involved) must be satisfied that the settlement agreement is fair and reasonable, taking into account the claims made on behalf of the members who will be bound by the settlement and potential conflicts between the funder, lawyers and the members, as well as between members.
248.95	In satisfying themselves that the proposed settlement is fair and reasonable, counsel should take into account, among other things, the following factors: a) the amount offered to each member; b) the prospects of success in the proceeding (ie the weaknesses, substantial or procedural, in the case advanced by the members); c) the likelihood of members obtaining judgment for an amount significantly in excess of the settlement sum; d) whether the settlement sum falls within a realistic range of likely outcomes; e) the attitude of the group members to the settlement; f) the likely duration and cost to members of proceedings if continued to judgment; g) the terms of any funding agreement about the procedure that will be applied in reviewing and deciding whether to accept any settlement offer, including the factors that will and will not be taken into account in deciding to settle; h) whether the funder might refuse to fund further proceedings if the settlement is not approved; and i) whether the settlement involved any unfairness to any member or categories of members for the benefit of others.
248.97, 98	Senior Counsel should also take into account the potential for conflicts of interest between members in accordance with the test applied by Jessup J in <i>Darwalla Milling Co Pty Ltd v F Hoffman – La Roche Ltd (No 2)</i> (2006) 236 ALR 322 at [41], namely Senior Counsel should determine whether the settlement involved any actual or potential unfairness to any member or categories of members having regard to all relevant matters, including whether the overall settlement sum involved unfair compromises by some members or categories of members for the benefit of others, and whether the distribution scheme fairly reflected the apparent or assumed relative losses suffered by particular members or categories of members.

