Corporations Amendment (Improving Outcomes for Litigation Funding Participants) Bill 2021
Submission 6

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5 November 2021

Committee Secretary
Parliamentary Joint Committee on Corporations and Financial Services
PO Box 6100
Parliament House
Canberra ACT 2600

By email: corporations.joint@aph.gov.au

Dear Secretary

Inquiry into the Corporations Amendment (Improving Outcomes for Litigation Funding Participants) Bill 2021

We have been invited to make a submission in respect of the above Inquiry. Our area of research specialisation is Insolvency Law. As such, similar to our previous submission relating to litigation funding, our submission will focus on the potential impact, if any, of the Corporations Amendment (Improving Outcomes for Litigation Funding Participants) Bill 2021 (Cth) on litigation funding in the context of external administration (insolvent litigation funding), rather than in the context of the typical 'class action'.

1) Relevance of proposed reforms to insolvent litigation funding

The proposed reforms appear to be targeted at 'class action litigation funding schemes', the dominant purpose of which is to 'seek remedies to which *7 or more persons*[1]…may be legally

[1] Own emphasis.

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entitled'.[2] In the context of insolvent litigation funding proceedings, the claimant/s will be the liquidator and/or the company in administration – a maximum of 2 persons. On this basis, insolvent litigation funding arrangements appear to fall outside the scope of application of the reforms proposed under the Corporations Amendment (Improving Outcomes for Litigation Funding Participants) Bill 2021 (Cth).

The conclusion that insolvent litigation funding arrangements appear to be excluded from the proposed reforms rests not only on the proposed definition of 'class action litigation funding scheme, but is further supported by the emphasis on the reforms being relevant to a 'a class action litigation funding scheme *that is a managed investment scheme*'.[3] It could be argued that insolvent litigation funding arrangements are excluded from managed investment schemes under the 'litigation funding arrangement' exemption in terms of Regulation 5C.11.01(5).[4] An alternative argument is that insolvent litigation funding arrangements fall outside the overarching definition of management investment schemes in any event,[5] on the basis that the liquidator, who is a party to the litigation funding arrangement, may retain control over the recovery proceedings, thus not satisfying the definition of 'management investment scheme'.[6]

For these reasons, it is submitted that the proposed reforms such as the power of the Court to vary the claim proceeds distribution method;[7] the 'fair and reasonable test' and accompanying extraordinary measure of fettering the Court's discretion,[8] along with the rebuttable presumption to provide for a quasi-cap of 30%;[9] as well as requirements for a referee report and representations by a contradictor,[10] will not apply to insolvent litigation funding arrangements.

2) Regulatory gap in respect of insolvent litigation funding remains

We previously commented on the oversight and quasi-regulatory role that the Court assumed in the context of insolvent litigation funding.[11] This is due to the operation of s 477(2B) of the

[2] Corporations Amendment (Improving Outcomes for Litigation Funding Participants) Bill 2021 (Cth), cl 5, inserting s 9AAA 'Meaning of class action litigation funding scheme'.
[3] Corporations Amendment (Improving Outcomes for Litigation Funding Participants) Bill 2021 (Cth), Schedule 1, items 6 and 7 propose to insert numerous provisions limiting the scope of application to 'a class action litigation funding scheme that is a managed investment scheme'.
[4] See ARITA, Submission to ASIC, *Consultation Paper 345: Litigation Funding Schemes: Guidance and Relief* (20 August 2021) 2 – 3.
[5] *Corporations Act 2001* (Cth), s 9.
[6] See ARITA, Submission to ASIC, *Consultation Paper 345: Litigation Funding Schemes: Guidance and Relief* (20 August 2021) 3 – 4.
[7] Corporations Amendment (Improving Outcomes for Litigation Funding Participants) Bill 2021 (Cth), Schedule 1, items 7, s 601LG(1)(b) of the *Corporations Act 2001* (Cth).
[8] Corporations Amendment (Improving Outcomes for Litigation Funding Participants) Bill 2021 (Cth), Schedule 1, items 7, s 601LG(3) of the *Corporations Act 2001* (Cth).
[9] Corporations Amendment (Improving Outcomes for Litigation Funding Participants) Bill 2021 (Cth), Schedule 1, items 7, s 601LG(5) of the *Corporations Act 2001* (Cth).
[10] Corporations Amendment (Improving Outcomes for Litigation Funding Participants) Bill 2021 (Cth), Schedule 1, items 7, s 601LG(6) of the *Corporations Act 2001* (Cth).
[11] See Sulette Lombard and Christopher Symes, Submission No 4 to the Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into Litigation Funding and the Regulation of the Class Action*

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Corporations Act 2001 (Cth) which requires a liquidator to obtain the approval of the Court, committee of inspection or by way of a resolution of the creditors to enter into an agreement that would exceed 3 months, which would typically include litigation funding agreements. As stated previously, even though judicial oversight in the context of insolvent litigation funding functions as a regulatory 'gap-filler' in the absence of any other type of regulation, this situation is far from ideal for a number of reasons.[12] Firstly, the Court made it clear that the standard required for approval under s 477(2B) does not involve exercise of a commercial judgment in respect of the terms of the agreement, but only an assessment of whether the entry into the litigation funding agreement is a proper exercise of the liquidator's power, and not ill-advised or improper[13] – this is clearly a very different function compared to the function that is to be assumed under the proposed reforms. Secondly, it should be noted that not all litigation funding agreements will require Court approval (for example, where approved by the committee of inspection or resolution of creditors). Thirdly, inconsistent approaches and outcomes could create uncertainty.

The exclusion of insolvent litigation funding arrangements from the proposed reforms would essentially mean development of parallel regulatory frameworks in respect of class action litigation funding and insolvent litigation funding. Class action litigation funding arrangements will be regulated extensively in terms of statute, whereas insolvent litigation funding arrangements will remain largely unregulated. Apart from obvious concerns around the advisability of a dual regulatory framework in respect of litigation funding arrangements, we express disappointment about the opportunity that will be missed to provide regulation in respect of concerns that exist in respect of litigation funding more broadly.

3) Conflicts of interest

There is a proposal to amend the Corporations Regulations 2001 to impose prohibitions and sanctions on funders, in particular, those who are also lawyers, with respect to addressing conflicts of interest.[14] The AFSL will have conditions that the lawyer cannot have or obtain a material financial interest in the funder and that the lawyer who may be providing services must ensure that if they have a material financial interest that they stop providing services or relinquish their interest. In recent research in which we are involved we are aware that, in some countries, insolvency practitioners may also be carrying material financial interests in litigation funders. While the Australian position is presently unclear with regard to how many insolvency practitioners act as litigation funders it would appear that all funders should be required to maintain adequate practices for managing conflicts of interest, whether they be lawyers or other professionals such as insolvency practitioners.

Industry (9 June 2020); Sulette Lombard and Christopher Symes, 'Judicial Guidelines for Insolvent Litigation Funding Agreements' (2020) 28 *Insolvency Law Journal* 165.

[12] Sulette Lombard and Christopher Symes, Submission No 4 to the Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into Litigation Funding and the Regulation of the Class Action Industry* (9 June 2020), 4.

[13] See eg *Re Gerard Cassegrain & Co Pty Ltd (in liq)* [2013] NSWSC 257, [11].

[14] Explanatory memorandum, Corporations Amendment (Improving Outcomes for Litigation Funding Participants) Bill 2021(Cth), 40.

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Insolvency practitioners such as those acting as liquidators have fiduciary obligations.[15] They must avoid conflicts of interest and a liquidator cannot profit from their position except by way of remuneration and so to have a material financial interest in a funder would be in breach of their duty.[16] Insolvency practitioners who are aware of a conflict should apply to the court for leave to resign.[17] Additionally, as liquidators are 'officers' for the purposes of the Corporations Act, under s182 they are not to make improper use of their position to gain an advantage and so engaging a funder in which they held a material financial interest would be in breach of this position. Despite all of this, the Corporations Regulations could give express prohibition to insolvency practitioners being financially interested in funders as a way of addressing these conflicts.

4) Potential indirect impact of proposed reforms on insolvent litigation funding

Even though insolvent litigation funding arrangements seem to fall outside the direct scope of application of the proposed reforms, we are furthermore concerned that the impact of the reforms on the litigation funding market more generally will have adverse consequences also in respect of insolvent litigation funding. The additional cost burden on litigation funders in respect of the fees of the referee report and representations by a contradictor[18] along with the quasi-cap imposed in terms of the rebuttable presumption in relation to the 'fair and reasonable test',[19] will potentially cause litigation funders to leave the market and consequently reduce competition.

In conclusion, we appreciate the fact that the proposed reforms recognise that some of the concerns that exist in respect of litigation-funded class actions are not necessarily present in the insolvency context and that a nuanced regulatory approach is required. However, we submit that issues that exist in the context of litigation funding in the context of external administration should not be overlooked as a result.

We would be happy to answer any questions you may have in relation to our submission.

Yours sincerely,

Associate Professor Sulette Lombard (University of South Australia) and

Professor Christopher Symes (University of Adelaide)

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[15] See Beth Nosworthy and Christopher Symes, 'The Liquidator: A Hybrid of Agent, Fiduciary and Officer' (2016) 31 *Australian Journal of Corporate Law* 65.
[16] Insolvency Practice Schedule (Corporations) s 60-20; *Commissioner for Corporate Affairs v Harvey* [1980] VR 669.
[17] *Commissioner for Corporate Affairs v Harvey* [1980] VR 669.
[18] Corporations Amendment (Improving Outcomes for Litigation Funding Participants) Bill 2021 (Cth), Schedule 1, items 6, s 601GA(5)(a)(v) of the *Corporations Act 2001* (Cth).
[19] Corporations Amendment (Improving Outcomes for Litigation Funding Participants) Bill 2021 (Cth), Schedule 1, items 7, s 601LG(5) of the *Corporations Act 2001* (Cth).