Australia's Litigation Funding Reforms Remain Contentious

The regulation of litigation funding remains a hot topic in Australia. In 2020, significant reform occurred with the Corporations Amendment (Litigation Funding) Regulations 2020 (Cth) (**Regulation**). The Regulation required litigation funders to hold an Australian Financial Services Licence and be registered as a managed investment scheme for any class action. It also subjected litigation funders to regulatory oversight by ASIC.

In October 2021, the Australian government proposed further reforms. The Corporations Amendment (Improving Outcomes for Litigation Funding Participants) Bill 2021 (**Bill**) seeks to address recommendations made by the Parliamentary Joint Committee on Corporations and Financial Services on litigation funding and the regulation of class actions. The federal government claims the reforms are aimed at providing greater transparency and protection to group members in class actions. On 3 February 2022, the federal government Senate Economics Committee endorsed the Bill.

This article is the first part of a litigation funding series. The series will review, assess and comment on the Bill, the proposed reforms, significant developments and the potential consequences and benefits of the reform from various perspectives, including in external administrations.

The Bill

The Bill, which has now been delayed until after the election, provides a statutory mechanism for mandatory court oversight on the distribution of class action proceeds between litigation funders and members of the litigation funding scheme. It stipulates that any distribution of claim proceeds must be approved by the court as "fair and reasonable". The Bill requires any litigation funding agreement to set out the proposed distribution methodology in order to provide full transparency and disclosure to group members. A litigation funder is not permitted to enforce a litigation funding agreement (**LFA**) unless:

- The distribution methodology has been approved by the court
- The group member has signed the LFA

If the court determines the distribution methodology is not fair and reasonable, it will have the power to vary the proposed distribution methodology to ensure it is fair and reasonable. The Bill seeks to provide assistance to the court and transparency to litigation funders by setting out a number of the factors the court will be bound to consider in assessing the methodology. In a move consistent with other laws passed during the pandemic, the factors set under the Bill may be varied or supplemented via the regulations. This effectively permits the federal government to respond to any uncertainty arising out of the Bill or to otherwise introduce new considerations via regulation.

Key Considerations for the Court

If approved, the Bill will require a court to have regard to the following factors when assessing a distribution methodology:

- In relation to the proceedings:
  - The amount, or expected amount of claim proceeds
  - The legal costs incurred by the funder
  - Whether the proceedings have been managed in the best interests of the general members to minimise the legal costs for the proceedings
  - The complexity and duration of the proceedings
- The commercial return to the funder in comparison to the costs incurred by the funder
- The risks accepted by group members who entered into a litigation funding agreement
- The sophistication and level of bargaining power of the general members in negotiating the agreement
- Any other compensation or remedies available to the scheme members

To assist the court, it must receive and consider a report from a litigation funding fees assessor and arguments from a contradictor. The litigation funder is responsible for the fees of all third parties assisting the court.

A key and controversial component of the Bill is a rebuttable presumption that a distribution methodology is not fair and reasonable if less than 70% of claim proceeds are paid to group members.

Power Remains With the Court

Ultimately the determination of whether the distribution methodology is fair and reasonable is a subjective decision at the discretion of the particular judge presiding over a matter. That determination would ordinarily be based on the relevant facts, matters and circumstances central to the LFA in question and the underlying proceeding or claim.

The principles set out in the Bill are aimed at guiding the court while it retains its discretion; however, the cap seeks to limit that discretion by imposing a mandatory baseline split.

Potential Impacts on Class Actions

Litigation funding plays an important role in enabling access to the civil justice system for those who would not otherwise be able to commence proceedings against third parties due to the high costs and risks of litigation. In particular, litigation funding creates greater accountability and transparency for corporations and government. LFAs are common across various sectors not limited to securities class actions – they have been and remain prevalent in external administration contexts and play important roles.

The federal government contends that the reforms are aimed at protecting group members by:

- Increasing transparency for group members on the proposed distribution methodology prior to signing a litigation funding agreement
- Only binding those group members who have signed a funding agreement
- Ensuring a fair and equitable distribution to group members for their loss
- Increasing accountability for lawyers and litigation funders by essentially capping the litigation funding fee and legal fees

Despite those potential benefits, are there also potentially unfortunate or unintended consequences attached to the reforms. If passed as currently framed, the Bill has the potential to have a chilling effect on the commercial risk profiles of funders. Two underlying reasons for that are the likely mandatory capped returns and the increased overall regulatory and oversight costs.

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