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Re: Te Aka Matua o te Ture | Law Commission Issues Paper 45: *Class Actions and Litigation Funding*

1. Introduction

1.1 The New Zealand Law Society | Te Kāhui Ture o Aotearoa (**Law Society**) welcomes the opportunity to comment on the Law Commission Issues Paper 45 *Class Actions and Litigation Funding* (**Issues Paper**).

1.2 The Law Commission is undertaking a review of class actions and litigation funding, which includes consideration of whether, and to what extent, the law should allow class actions, and whether, and to what extent, the law should allow litigation funding having regard to the torts of maintenance and champerty.

1.3 The Law Society's Civil Litigation and Tribunals Committee and its Regulatory division have considered the Issues Paper and assisted in preparing this submission. The submission is structured as follows:

Section 2: executive summary

Section 3: considers the need for a statutory framework governing class actions and sets out the Law Society's preliminary views regarding the scope, principles and objectives, and applicable procedure of such a regime

Section 4: discusses the desirability of litigation funding and includes commentary on the possible nature and extent of a regulatory response

1.4 The submission does not provide individual responses to the consultation questions set out in the Issues Paper given the difficulty in providing specific responses to hypothetical questions in the absence of firm reform proposals. Instead, the submission provides preliminary feedback regarding some of the key themes and issues that we consider arise in the context of class actions and litigation funding. We welcome the opportunity to provide further, more detailed, feedback on specific reform proposals in the next phase of consultation.

2. Executive summary

2.1 The Law Society agrees with the Law Commission that a statutory class actions regime is appropriate and necessary. When designing the statutory regime, it will be important to strike the right balance between competing key objectives, including promoting claimants' access to justice; upholding the objectives of the High Court Rules 2016;[1] supporting litigation funders in achieving investment outcomes; and facilitating defendants' access to justice. The regime must also be equipped to deal with relevant procedural matters, while recognising that the courts will require a certain degree of flexibility and discretion to ensure the regime is not overly prescriptive.

2.2 The Law Society also agrees in principle that litigation funding is desirable and requires a regulatory response. The regulatory response should recognise that litigation funding is essentially a financial product, and that many concerns relating to litigation funding can be addressed by good practice market mechanisms for financial products.

2.3 Amendments to the Lawyers and Conveyancers Act (Lawyers: Conduct and Client Care) Rules 2008 (**Conduct and Client Care Rules**) may also be required to recognise the various professional issues that can arise in tripartite relationships involving funders (including conflicts of interest).

3. Statutory framework for class actions

Overview

3.1 The Law Society agrees that a statutory framework to govern class actions is appropriate and necessary.

3.2 The existing framework to address group-based litigation under rule 4.24 of the High Court Rules is inadequate to deal with the modern evolution of class actions. A full statutory framework is therefore preferable and is best suited to balance the advantages of class actions (including access to justice) against the potential disadvantages that may arise.

Is rule 4.24 of the High Court Rules an adequate framework for group litigation?

3.3 We do not consider that rule 4.24 of the High Court Rules provides an adequate framework to address the various issues arising from the increasing number of class actions in New Zealand. Rule 4.24 is framed as a representative action procedure, which was originally developed in the 17th and 18th centuries by the Courts of Chancery in response to the "complete joinder rule", and was first introduced into New Zealand's court rules in 1882.[2] While the rule has historically served a useful function, and affords the courts broad and flexible powers to mould procedural rules to the particular case, it is ill-suited to respond to the complexities of modern class action claims. The Law Society agrees that the representative action procedure was not designed for claims of the scale and complexity of present day class actions. Comparable overseas jurisdictions have moved on from the representative actions rule, choosing to adopt more bespoke class actions regimes.

3.4 Given the lack of detail with the rule, and the relatively nascent nature of class actions in New Zealand, the current framework provides inadequate guidance and predictability for

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1 High Court Rules 2016, r 1.2, which states that the objective of the Rules is "to secure the just, speedy, and inexpensive determination of any proceeding or interlocutory application".

2 Law Commission, Issues Paper 45 (Issues Paper), at 2.26 and 4.15.

parties in class action proceedings. The courts have developed a number of principles or features that apply to class action proceedings operating within the rubric of rule 4.24,[3] but the development of applicable principles and procedures has necessarily been on a case by case basis. Furthermore, there are a number of significant issues which have not received judicial consideration because they have not yet arisen in a particular case.[4] The incremental nature of class action jurisprudence is inefficient and the uncertainties associated with the status quo also invite interlocutory applications, and subsequent appeals, which can operate as a barrier for plaintiffs seeking to issue a proceeding.[5]

If rule 4.24 is not an adequate framework, is it desirable to facilitate group litigation through a statutory class actions regime?

3.5 We agree that a statutory class actions regime will better facilitate group litigation than the existing framework under rule 4.24 of the High Court Rules. Implementing a statutory regime enables policy considerations to be assessed and debated, and permits wide stakeholder consultation.[6] The Law Society agrees that a statutory regime can provide greater certainty, predictability and transparency of the law. Such an approach is preferable to the incremental development of the class actions rules that the courts are otherwise constrained to undertake under rule 4.24.

3.6 The Law Society considers there are some key benefits with a statutory framework:

a. First and foremost, a class actions regime would promote access to justice in instances where there is a group of claimants with a commonality of interest. There are a number of impediments to parties seeking redress through our legal system, including high legal costs of pursuing civil litigation, the risk of adverse costs awards, social barriers, and the stresses associated with being a party to a proceeding.[7] A class actions regime is able to mitigate those impediments to a considerable degree.

b. Second, a class actions regime also has the potential to improve efficiency and economy of litigation. Enabling group litigation avoids unnecessary multiplicity of proceedings that might otherwise arise when there are a large number of plaintiffs. This reduces the burden on court resources required to determine the plaintiffs' claims. It also reduces the risks of inconsistent judgments on the same issue.

c. The third benefit often associated with class actions is the strengthening of incentives for compliance with the law (for fear of being held to account through a class action). The evidential basis for this claim is questionable, as it is inherently a difficult effect to measure.[8] If accurate, this would (of course) be a positive effect of any class action regime, but it should not be a driving principle behind the architecture of a class actions regime.

3.7 At the same time, an increase in class actions has the potential for adverse effects. For example, there is a risk that there could be an increase in claims generally, including vexatious claims. That would, in turn, place an increased burden on the courts and their

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3 Issues Paper at 4.2.

4 Issues Paper at 4.13 and 4.18, citing the Supreme Court in *Southern Response Earthquake Services Ltd v Ross* [2020] NZSC 126, which stated at [94] that "*…there are a number of procedural and other matters that will simply have to be worked through as the issues arise in a particular case*".

5 See other problems identified by the Law Commission at 4.22 of the Issues Paper.

6 Issues Paper at 4.8.

7 Issues Paper at 5.9 and following.

8 See, for example, Issues Paper at 5.47 and following.

resources. It is acknowledged that class actions tend to require greater judicial supervision and closer case management than what is required in a standard civil proceeding.

3.8 A greater number of class actions, some of which may be of dubious merit, will inevitably be most vexing on defendants. The Law Commission identifies that a defendant will incur legal costs irrespective of whether it is found liable, especially as adverse costs awards are only intended to be a contribution towards the successful party's legal costs.[9] There are also indirect non-financial costs which a defendant will face, including the opportunity cost associated with defending a claim, and reputational concerns. The increased cost of insurance premiums is also frequently cited by defendants as an adverse consequence of class actions. This may encourage defendants to settle unmeritorious claims.

3.9 There are, however, three responses to those concerns:

a. first, a new statutory regime is able to be designed to address (at least some of) those risks;

b. second, there are a number of existing mechanisms within the court's procedural rules (such as security for costs orders, strike out applications, and increased or indemnity costs for vexatious, frivolous or improper claims) that can ameliorate the potential concerns associated with an increase in class actions; and

c. third, an increase in meritorious claims is not an adverse effect; rather it is the natural consequence of improving access to justice.[10]

3.10 Furthermore, while there has been an increase in representative actions in New Zealand within the last 20 years, they still comprise a small percentage of all civil claims. It can be expected that the rising trend of group litigation will continue due to greater availability of litigation funding (often from overseas), and an increased public awareness of class actions generally. But the disadvantages which inevitably follow the increase in the number of class action proceedings does not outweigh the benefits of greater access to justice.

3.11 It is also important to note that any statutory regime will need to take into account the different policy issues that may arise in the context of non-funded class actions (when 'de-coupled' from a litigation funding regime). Funded claims may, in part, be motivated and conducted in different ways from a class action which is not funded by a litigation funder. Measures that may be introduced to safeguard against unwanted 'over-reach' from funded claims must not become a barrier to non-funded class actions.

3.12 A class actions regime ought not to interfere unreasonably with the role of regulators enforcing the law. A regulator's objectives in determining whether or not to issue enforcement proceedings, and which claims to bring, may only partially align with the objectives of a class of plaintiffs. Regulators also have resourcing constraints, and need to prioritise which enforcement actions they pursue. Class actions can sit alongside regulator-initiated claims, filling the gaps when appropriate, and serving a different purpose (for example, class action members may be primarily incentivised to obtain damages or compensation, whereas a regulator may prioritise other outcomes such as the development of the law).

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9 Issues Paper at 6.14 and following.

10 The Law Commission also importantly notes at 7.38 of its Issues Paper that "…*a class actions regime is a procedural device which makes it easier for litigants to pursue existing causes of action, rather than creating any new forms of legal liability*".

Determining the scope, principles and objectives, and applicable procedure of a statutory regime

Scope

3.13 It is appropriate that any statutory regime ought to have a broad or general scope. Class actions have the ability to touch on a broad range of legal issues, and there appears to be no basis to seek to limit the regime to any particular sectors. It would be a lost opportunity to enact a regime that is limited in nature.

3.14 There are advantages to the High Court having sole jurisdiction over a class actions regime.[11] Aside from claims fitting easily within the High Court jurisdiction in most cases, the High Court's inherent jurisdiction provides additional assistance when addressing procedural difficulties that may arise (and which would not be available to courts established by statute). That general position would not, however, preclude other courts from having jurisdiction to consider group-based litigation where the legislature considers it appropriate. For example, the Employment Court has jurisdiction to consider claims relating to groups of employees. Another example is the Māori Land Court, where issues of standing that are particular to customary authority have been developed and determined, and need not be subject to a statutory class actions regime.[12] However, the default position should be that the High Court has jurisdiction over class action proceedings.

3.15 While the Law Society expects that any new class actions regime would largely replace rule 4.24 of the High Court Rules, it is possible that the representative actions regime under rule 4.24 could co-exist with a statutory class actions regime. The rule may be retained for specific cases. For example, rule 4.24 was initially well-suited for dealing with simple representative actions. It is also useful when seeking to ensure that a group of defendants are bound by a declaration or direction issued by the court.[13] Therefore rule 4.24 appears to be better suited to deal with representative defendants/respondents than the problematic issues that would arise under defendant class actions.[14]

3.16 It may also be appropriate to retain other existing group-based litigation procedures that currently operate well and that need not be captured by a new class action regime. For example, judicial review proceedings may determine an issue which affects a wide group of individuals, but are not advanced as a class actions proceeding per se. There does not appear to be any reason to interfere with the broadly efficient procedures already in place to determine judicial review proceedings.

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11 The High Court has exclusive jurisdiction under other statutory regimes such as, for example, claims brought under the Companies Act 1993.

12 Issues Paper at 3.93 – 3.96 and 8.18.

13 For example, in the recent directions application brought by the liquidators of Halifax New Zealand Ltd (In Liq) (CIV-2019-404-2049), the Court made orders under rule 4.24 directing that certain investors of a failed investment fund be named as respondents to the proceeding in a representative capacity. This enabled different classes of investors to be represented, and have submissions made relating to the interests of their particular class, while also ensuring that the Court's determination will be binding on all of those investors within the representative classes.

14 See Issues Paper at 8.19 and following.

Principles and objectives

3.17 The Law Society agrees that access to justice is the clearest advantage of class actions and should be the main objective of a statutory class actions regime. Access to justice is a fundamental objective of New Zealand's legal system, and a class actions regime will further enhance that objective.

3.18 The framework must still consider other objectives, including (for example):

a. the objective of the High Court Rules, which is to secure the just, speedy, and inexpensive determination of proceedings (r 1.2);

b. balancing the interests of plaintiffs and defendants;

c. protecting the interests of class members; and

d. proportionality.

3.19 Treating "access to justice" alone as an *overriding* objective is not desirable. The High Court Rules already recognise in r 1.2 a different set of overriding objectives which emphasise proportionality in litigation. Upsetting this balance could have a significantly negative impact on defendants to class actions. There is considerable cost, time and effort involved in defending class actions. The cases are frequently complex and require many more steps than a standard proceeding, and are therefore more expensive. This concern is further fuelled by the rise in litigation funding.

3.20 Furthermore, defendants in certain cases may be involved in multiple proceedings relating to the same matter. For example, a defendant to a securities case may face a class action, a claim from their industry regulator, and a liquidation-based claim – with considerable overlap between each group of affected parties/complainants. Defendants might also face multiple class actions relating to the same underlying subject matter. In some instances, those claims may overlap, or even be competing with one another.[15]

3.21 The cost and burden on defendants can be prohibitive, resulting in incentives for unwarranted settlements. It is important to remember that access to justice also includes access to justice for defendants, and must result in *proportionate* access for all parties. Therefore, a class actions regime ought to have appropriate protections for defendants as well as plaintiffs.

Applicable procedure

3.22 Although the applicable procedure will be a crucial component of any class actions regime, it is difficult to discuss details of a regime in the abstract. The Law Society would prefer to comment in depth when the proposed detailed design of a statutory regime is made available for consultation.

3.23 However, the Law Society agrees that it would be useful to comment briefly on some of the key design features of a statutory class action regime. In particular:

[15] For example, two or more class actions may be competing for the same insurance monies payable to the defendants.

a. *Certification*: the Law Society sees merit in a certification process, whereby an intending representative plaintiff will need to satisfy the court of various matters before the proceeding may continue as a class action (for example, commonality of factual or legal issues). A numerosity requirement can be considered on a case by case base at the certification stage, rather than turning on a prescribed, arbitrary, minimum class size. The Law Society agrees with the Ontario Law Reform Commission that:[16]

> "… class actions are sufficiently different from individual proceedings to require a special judicial filter to weed out class actions that are contrary to the interest of the class members, the defendant, or the public."

b. *Protection of class members' interests*: comparative class actions regimes overseas often include features to protect class members' interests. This is an important feature to incorporate in a new regime. Class members do not usually play an active role in the proceeding, but they will be bound by the court's determination. Appropriate features would include adequate notice to class members (particularly in an opt-out class action), and court approval of settlements.

c. *Determining class membership*: a statutory regime should provide a degree of flexibility, enabling a class membership to be determined by an 'opt-out', 'opt-in', or 'universal' approach, as best suits the circumstances of the particular case.

d. *Flexibility*: a statutory regime ought to provide a degree of flexibility for individual cases before the courts. While a suitably prescribed regime will provide greater certainty, predictability and transparency than the status quo, it must not act as a straitjacket precluding the court from implementing procedures that are most appropriate for any particular proceeding. There are certain procedural aspects of class actions which are capable of, and ought to be, contained within a statutory regime. But the regime need not be overly prescriptive, given the general rules of procedure already available to the courts. The Law Society agrees that consideration should be given to which matters should be contained within a class actions statute, and those that should be in the High Court Rules (which the Rules Committee has responsibility for).[17]

e. *Active court supervision*: class actions may require judges to be more involved than in a standard civil proceeding. It is important for judges to be more active in order to make the regime work. The complex nature of class actions, and the varying interests of stakeholders, requires the courts to take an active role in the proceedings, both from a case management perspective and also in a supervisory capacity.

f. *Adequacy of representation*: the Law Society's view is that a representative plaintiff ought to adequately represent the class; they must show that they will fairly and adequately represent the group; and be a member of the class (rather than an ideological representative).

g. *Conflicts of interest*: any regime ought to address conflict issues that may arise in class actions, including, for example, as between the representative plaintiff and the

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16 Ontario Law Reform Commission *Report on Class Action* (Volume I, 1982) at 281, cited by the Law Commission at 2.7 of the Issues Paper.

17 Issues Paper at 7.43.

class members; where a plaintiff is employed by the law firm acting for the class; and where the plaintiff represents a class in more than one proceeding. The Conduct and Client Care Rules will also need to be amended to address such conflicts, as they are not currently equipped to deal with the range and complexity of professional issues which arise from multi-party relationships in class actions.[18]

h. *Government entity as a representative plaintiff*: the Law Society does not have any particular objection to a government entity being able to take advantage of a class actions regime and acting as a representative plaintiff.

4. Litigation funding

Overview

4.1 Litigation funding is both desirable in principle and an established fact of New Zealand litigation. The focus should therefore be on the nature and extent of any regulatory response.

4.2 The torts of maintenance and champerty are not the right models for regulating litigation funding. Their bluntness and ambiguity make them unsuitable for regulating sophisticated financial products. Moreover, their public policy rationale is no longer convincing. As is well known (including through recent research undertaken by the Law Society),[19] access to civil justice is a complex but acute problem in New Zealand. Litigation funding offers a partial solution, in particular by funding both party and adverse costs (including by provision of security) and is a better alternative than, for instance, permitting lawyers to act for contingency fees.[20] As Lord Neuberger has stated:[21]

> "[T]he public policy rationale regarding maintenance and champerty has turned full circle. Originally their prohibition was justifiable as a means to help secure the development of an inclusive, pluralist society governed by the rule of law. Now, it might be said, the exact reverse of the prohibition is justified for the same reason. The argument advanced by Acemoglu and Robinson appears positively to support the development of litigation funding, as a means of securing effective access to justice."

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18 Chapters 5 and 6, in particular, will require some amendments.

19 See, for example, New Zealand Law Society "Access to Justice: Stocktake of Initiatives", Research Report, December 2020, available at https://www.lawsociety.org.nz/about-us/significant-reports/access-to-justice-stocktake-of-initiatives/.

20 Compare ss 333 to 335 of the Lawyers and Conveyancers Act 2006, permitting conditional, but not contingency, fee agreements. Litigation funding does not remove the risks of conflicts of interest, but those risks present less directly than with contingency fees, for which the lawyer both holds a stake in and runs the litigation.

21 Lord Neuberger "From Barratry, Maintenance and Champerty to Litigation Funding", available at https://www.supremecourt.uk/docs/speech-130508.pdf, Harbour Litigation Funding First Annual Lecture (8 May 2013) at [48], referring to D Acemoglu & J Robinson *Why Nations Fail: The Origins of Power, Prosperity and Poverty* (London, Profile Books, 2012). See also His Lordship's address to the Australian Bar Association Biennial Conference on 3 July 2017, entitled "Access to Justice", available at https://www.supremecourt.uk/docs/speech-170703.pdf, which addresses the access to justice funding shortfall resulting, in part, from the retreat of civil legal aid as a genuine model for funding litigation.

4.3 The appropriate regulatory response should therefore be informed by the principle that litigation funding is a market mechanism – being essentially the provision of equity finance for litigation.[22] This approach has two main consequences:

a. First, as with other financial products, litigation funding should not be entirely self-regulated; and

b. Second, to the extent possible, legitimate concerns about litigation funding can and should be addressed by good practice market mechanisms for financial products – particularly insurance products (which provide an analogy) with some forms of litigation funding being akin to after-the-event insurance.[23] The main focus should be on facilitating transparent and open provision of information, including about the resources of the funder and the funding terms available. It is also sensible for regulation to address minimum capital adequacy/solvency requirements and to consider methods for standardising information to be provided to litigants, for ease of comparison.

4.4 This leaves the question of whether there are any aspects of litigation funding that cannot be addressed by good practice market mechanisms and that require an additional bespoke regulatory response. Care should be taken before so concluding, as it is important to be sure that one is responding to an intrinsic difficulty of litigation funding, rather than to its relative novelty.

4.5 The best articulation of a possible inherent difficulty of litigation funding is that, especially when combined with a class actions regime, there is the possibility of litigation proceeding without direct or meaningful input from *any* plaintiff, even a representative plaintiff. This has, in the literature, been called an "*agency*" problem,[24] due to the absence of a genuine principal.

4.6 The Law Society agrees that there are no public policy reasons to permit a pure market in litigation in the absence of a genuine principal, with the funder and lawyers effectively manufacturing and then running a claim on their own account. There are potential risks that such a market would alter the incentives underlying ordinary litigation with possible adverse outcomes for defendants. Such a mechanism is, in any event, not warranted to address access to justice issues, which is the main argument in favour of facilitating litigation funding.

4.7 A more difficult question is whether a genuine principal should be able to enter into an agreement with a funder providing for a bare assignment of a claim, functioning as a kind of after-the-fact subrogation. It is not clear that public policy ought in all cases to prohibit such

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22 Although it is possible for litigation funding to be provided by way of debt – and in practice some litigants finance their litigation by borrowing, such as from friends and family – the phenomenon of modern litigation funding is really a form of investment, or hedge, fund; investing for equity return rather than lending for repayment at interest.

23 Note that many of the questions posed in the Issues Paper are similar to those addressed, in an insurance context, by the Insurance (Prudential Supervision) Act 2010. These include the need for licensing (ss 15 and 16), prudential supervisory control by the Reserve Bank (ss 17 to 25 and Part 3), the requirement for fit and proper policies to apply to directors and officers (ss 34-43), capital adequacy/solvency standards (ss 55-59) and a public and standardised financial strength rating system (ss 60-71).

24 See, for example, the insightful analysis by Samuel Issacheroff, the Reiss Professor of Constitutional Law, New York University, in "Litigation Funding and the Problem of Agency Cost in Representative Actions" (2014) 63 DePaul L Rev 61.

resolution taking the form of assignment to and payment from a licensed litigation funder, with the funder then continuing the litigation in the name of the plaintiff.

4.8 It does seem essential that litigation funding should always proceed through an agreement between a funder and a principal or principals who is/are genuine client/s with an interest in the outcome of the litigation and (until the point of any permitted assignment) the ability to give instructions in respect of it.

4.9 The Law Society is not convinced, at this stage, that the above objective is best achieved by specific regulation, for instance as to the nature, extent or indicia of control, or as to the percentage of the claim value that can be effectively transferred to the funder. It is preferable to regulate this aspect of litigation funding by way of principles and standards, with a requirement for all funding agreements in respect of:

a. what might be termed 'sensitive funding agreements', which might be defined as those involving bare assignments (if permitted), or any other loss of control or specified profit threshold (say, greater than 50% in each case); and

b. representative or class actions,

to be approved by the High Court, with greater detail to be determined by the courts on a case-by-case basis.

4.10 These issues are explored in further detail below.

<u>Is litigation funding desirable in principle?</u>

4.11 Yes. Currently, there is an access to justice problem in New Zealand and, by providing an equity (that is, non-recourse) funding model for litigation (including both party and adverse costs), litigation funding can and does provide an additional method for plaintiffs to pursue their claims in court through to a final determination.

4.12 A combination of class actions and litigation funding, if handled appropriately, can enhance access to justice for claims – especially smaller consumer or securities claims – that could otherwise not cost-effectively be brought.

4.13 Although there are valid concerns about litigation funding, many of these are best understood as arising not as a matter of principle, but as a matter of proper regulation. It should not be overlooked that, being investment funds, litigation funders tend to put greater analysis and effort into up-front analysis of the likely prospects of success and expected return than do many litigants. Fears that litigation funding will increase unmeritorious claims, or resist sensible settlements, are therefore likely to be exaggerated. Such concerns are, in any event, best addressed through regulation of funders themselves to ensure that the participants in this market are fit and proper. Litigation funders will, of course, be less emotional and personally invested in litigation than the plaintiffs themselves. But that has advantages (judgement remaining unimpaired by strong emotion) as well as disadvantages (reduced prospect of settlement for purely reputational or personal reasons).

4.14 Further, funding arrangements can present ethical concerns for lawyers whose interests in a funded claim can potentially (depending on the funding terms) become more closely aligned with its overall success. In the Law Society's view, this situation is not different in essence from that obtained under a conditional fee agreement. Contingency fees for lawyers should remain prohibited. Ethical issues relating to tripartite agreements are considered below and should be addressed further, if at all, in a wider context that also addresses lawyers acting for insurers and policyholders.

Is a regulatory response to litigation funding warranted, or should the courts be left to clarify and develop the common law?

4.15 A regulatory response is required for the following reasons:

a. The courts' ability to clarify and develop the common law is presently through the vehicles of maintenance and champerty, which is inadequate for regulating a sophisticated financial product and strikes the wrong public policy balance. The torts evolved in the 16th century to address a different problem – of influential people in a small society using litigation as an instrument to persecute (often political) rivals. That is not the primary concern with modern litigation funding. Lord Neuberger observed that "*funding is the life-blood of the justice system … [It] helps maintain our society as an inclusive one …. [A]ccess to justice is of the essence in a civilised society*".[25] The Law Society respectfully agrees. A market-based mechanism for modern litigation funding does not create or exacerbate the risks of litigation being used inappropriately to settle scores, but has a different mixture of risks and benefits.

b. A regulatory response to litigation funding, as a financial product, helps protect users from misinformation and funders who lack substance or scruples. As with other providers of financial products, the more appropriate form of regulation is in the first instance statutory. Such regulation should, so far as possible, focus on good practice market solutions to perceived concerns about litigation funding.

If a regulatory response is warranted, how should the common law torts of maintenance and champerty be addressed?

4.16 Thought should now be given to whether the torts serve any useful purpose or should be abolished. If they are retained, thought should be given to clarifying whether and to what extent there are limits on the provision of ordinary debt finance for litigation. The Law Society has not examined the matter but considers it likely to be relatively common that litigants often borrow funds – from friends, relatives and financial institutions – to pursue litigation. The Law Society does not consider there are strong reasons to prevent such ordinary debt finance for litigation. If the torts are to remain, this should be clarified.

4.17 More importantly, the torts should not regulate the phenomenon of litigation funding – which the Law Society understands to mean equity or non-recourse debt funding – as that should be regulated by and through a separate statutory regime (thus being carved out from any vestiges of the torts that may remain). Such a regime, as outlined below, should be a code for the provision of litigation funding in New Zealand.

Assessment of key concerns regarding litigation funding

4.18 Any regulatory response should consider what proper assessment and weight ought to be ascribed to concerns about litigation funding, principally including: funder control of litigation; conflicts of interest; funder profits; and capital adequacy of funders.

4.19 This will turn on a proper analysis of the phenomenon of litigation funding. As already discussed above, the Law Society at this stage suggests proceeding as follows:

[25] Above n 21 at [52], [53] and [55].

a. Litigation funding is best conceived of as a financial product, which is, in turn, best regulated through market-mechanisms supplemented, as appropriate and necessary, through regulatory requirements;

b. For each of the four stated concerns, it is useful to consider both their *relative importance* and to what extent the concerns are *intrinsic to litigation funding* and thus need to be addressed by a bespoke regulatory regime, or more generic concerns that only appear to be particular to litigation funding due to the relative novelty of this phenomenon; and

c. To the extent possible, more generic concerns should be addressed in a more general way. A bespoke regulatory regime for litigation funding is, as noted below, appropriate, but should only seek to address and regulate matters that cannot be appropriately addressed and regulated generically.

4.20 The Law Society's assessment of these four concerns is set out schematically below:

	Important?	**Specific?**
Capital adequacy	Yes	Yes
Conflicts of interest	Yes	No
Funder control	Unclear	Yes
Funder profits	Unclear	Yes

Capital adequacy

4.21 Capital adequacy requirements are important and require specific regulation so that users can have confidence in the litigation funding market.

Conflicts of interest

4.22 Concerns regarding conflicts of interest are important. Conflicts of interest can be appropriately regulated through the common law[26] and the Conduct and Client Care Rules, provided the Rules are updated to recognise the range and complexity of professional issues which potentially arise in tripartite and multi-party relationships.[27]

4.23 In their present form, the Conduct and Client Care Rules are not well-equipped to address issues such as conflicts of interest (as well as related issues including lawyers' obligations of independence and undivided loyalty to plaintiff-clients, confidentiality and disclosure, client autonomy in the selection and engagement of lawyers, and the no contact rule). Some of these issues may be anticipated and addressed in terms included in litigation funding agreements, however, there is a risk that such terms are irreconcilable with existing

26 For instance, *Black v Taylor* (1993) 2 NZPC 200, [1993] 3 NZLR 403 (CA).

27 The Rules could be updated by amending, for example: Rule 5, to recognise the potential for compromised compliance with the lawyer's duties of independence where the lawyer has duties and loyalties to both the plaintiff and the funder; Rule 5.3, if the objectives of the plaintiff and the funder diverge on issues (such as the acceptance or rejection of a settlement offer, or reliance on a particular cause of action); Rule 6.1, to recognise the obvious potential for multi-party conflicts of duty when clients within a class have differing expectations or interests (including the acceptance or rejection of a settlement offer or other litigation decisions); and Rule 8, to recognise possible confidences kept from the funder on matters in which the funder would expect to be kept informed.

principles of independence in the lawyer-plaintiff relationship. Some amendments to the Conduct and Client Care Rules would therefore assist in providing clarity and certainty to parties involved in such tripartite relationships.

4.24 Amendments should not, however, be limited to addressing issues specific to litigation funding. Any amendments should instead address conflicts of interest and other professional issues arising from *all* tripartite lawyer-client-third party relationships, and such amendments can be informed by guidance from High Court decisions (including, for example, decisions relating to the conduct of lawyers in tripartite relationships with insurers and policyholders).[28]

Funder control and profits

4.25 Questions about funder control and profits turn on a deeper question about whether litigation funding has special characteristics that require such specific regulation. The Law Society's principal position is that such questions should to the extent practicable be set by the market, with specific regulation only implemented where necessary and appropriate to address a clearly articulated public policy problem.

4.26 The best articulation of the specific problem is the risk of litigation funders and lawyers acting together to create and fund litigation without any real client at all. Such litigation then becomes a purely financial mechanism rather than a means of more efficiently monetising genuine claims.

4.27 Therefore, the Law Society considers it appropriate that the litigation funding market is restricted to the funding of genuine claims by genuine claimants. There must in all cases be a genuine claimant who signs a funding agreement with a funder. That funding agreement then becomes the source of the funder's rights and obligations with respect to the claim.

4.28 It is less clear whether the present prohibition on bare assignments of a claim should persist. If a genuine claimant is able to negotiate with and is willing to accept from a funder a one-off payment in lieu of the uncertainty of a litigation return, it is not clear that this is or should be considered to be a breach of an important public policy matter. Subrogated insurance claims are not considered to offend public policy, even though these will usually be conducted without any involvement from the insured. This is a matter the Law Society respectfully recommends the Law Commission consider and research further.

4.29 Beyond this point, the Law Society considers that any legislation should be on a principles and standards basis rather than be overly prescriptive. The courts should be given a duty and power to approve funding agreements in what we have termed above at [4.9] as 'sensitive funding agreements' and in class actions – which, in the latter case, will often take place at the same time as certifying class actions, settling payment of security for costs and otherwise providing for the efficient conduct of the litigation. The courts' role is not to usurp the market, but to support it, by making sure there is a true claimant who has made an informed choice to enter into a funding agreement that is not, in the context of the apprehended litigation, unreasonable or inappropriate.

4.30 Any specific guidance will undoubtably need to evolve. As noted above, the Conduct and Client Care Rules may also require further amendment to recognise that the funder may control the selection and engagement of lawyers, with a corresponding loss of autonomy by

[28] See, for example, *Nicholson v Icepak Coolstores Ltd* [1999] 3 NZLR 475 (HC) and *Gallaway v National Standards Committee* [2020] NZHC 3384.

the plaintiff.[29] The Law Society presently doubts, however, that legislative drafting can satisfactorily resolve all of the context-specific questions in advance of a court hearing and considers if it may be best not to seek to do so.

The nature and extent of a regulatory response

4.31 If a regulatory response is warranted, it is necessary to consider whether it should comprise or include: industry self-regulation; requiring litigation funders to include minimum terms in their litigation funding agreements;[30] creating mechanisms to encourage competition in the litigation funding market; strengthening the security for costs mechanism; regulating funded litigation as managed investment schemes; requiring litigation funders to hold a market services license; and/or something else.

4.32 As outlined above, the Law Society considers that:

a. Litigation funding is a financial product. Any regulatory response should therefore ensure that users of this product are properly informed, and market participants and fit and proper persons are appropriately capitalised.

b. It is, however, an unusual form of financial product. The regime in the Financial Markets Conduct Act 2013 (**FMCA**), which regulates financial products,[31] is designed to regulate the relationship between *investment funds (called "schemes") and their investors*. Here, the relationship requiring regulation is that between *investment funds and their investments*. In other words, what needs considering is not the general way in which litigation funders can raise capital, which – if they are a New Zealand scheme or raise capital in New Zealand – is presumably regulated by the FMCA.

c. The issue is what rules need to be made for how such funds should be regulated on account not of their capital-raising activities, but the business – being litigation – on which they then invest that capital. It is thus a truly market-based form of regulation.

d. An obvious analogy is the regulatory regime for insurance companies contained in the Insurance (Prudential Supervision) Act 2010. Litigation funding has obvious similarities to the insurance industry.[32] Some forms of litigation funding are a kind of after-the-event insurance. Insurance contracts do often result in insurers conducting litigation on a subrogated basis, and in a tripartite relationship between insurer, policyholder and engaged lawyers. Thus, the insurance regulatory model, which focuses on the financial strength of insurance companies and how this is communicated to policyholders,[33] has attraction as a possible model. Such an

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29 In particular, Rules 4 and 4.3.

30 Minimum terms could include, for example: mechanisms for resolving differences between plaintiffs and funders; clarity around lawyers' duties of confidentiality and disclosure; and clarity around the issue of selection, engagement and disengagement of lawyers.

31 See s 7.

32 Note that pure risk contracts of insurance are excluded from the definition of "*managed investment scheme*" in the FMCA: s 9(2)(c).

33 See, for example, s 64, which requires, a licensed insurer to, before entering into or renewing a contract of insurance with a New Zealand policyholder, disclose in writing to the policyholder the insurer's current financial strength rating; the name of the agency by which the rating was given; and the rating scale used.

analogy suggests a role for the Reserve Bank in regulating the prudential requirements for litigation funders.

e. Two other possible analogies are:

i. The Credit Contracts and Consumer Finance Act 2003, which regulates the conduct of those providing consumer credit contracts. The requirement for the publication of standard form contract terms,[34] initial and continuing disclosure,[35] the existence and statutory recognition of the Responsible Lending Code,[36] and court powers to control unreasonable or unfair lending[37] could all potentially be adapted to a litigation funding context; and

ii. The Financial Service Providers (Registration and Dispute Resolution) Act 2008, which requires any person in the business of providing financial services to be qualified[38] and a registered member of an approved dispute resolution scheme.[39] These requirements are regulated by the Financial Markets Authority (**FMA**).[40]

f. Whatever the design is, the regulatory regime must ensure that the litigation investment funders are fit, proper and solvent to offer their product in the marketplace and that they do so in a fair, balanced, transparent – and insofar as possible – standardised and comparable way. It is not clear that minimum funding terms are required to achieve this goal. Given the sophistication of litigation funding as a product, a main purpose of any regulatory regime should be to demystify what is on offer so that users can make an informed choice.

4.33 Standing back, the Law Society's view is that there is a risk, with any new regulatory model, of over-regulation which is not conducive to an effective and efficient market. The best approach is therefore likely to be:

a. Prudential regulation by the Reserve Bank; and

b. Operational regulation by the courts, rather than the FMA. The courts are best placed to review funding terms to make sure that every 'sensitive funding agreement', or funding agreement in the context of a class action, involves a genuine claimant who understands the terms they are signing up to (in the latter case, at the same time as addressing related matters such as security).

4.34 This suggests there may be scope to amend the High Court Rules to specify, especially in combination with the requirements for class action certification, what matters need to be addressed in an application for funding approval and the form of material, including affidavit material, that may be required.

5. Next steps

5.1 The Law Society is grateful for the opportunity to provide high-level feedback on the Commission's Issues Paper. We welcome the opportunity to provide further, more informed,

34 Section 9J.
35 Sections 17 and 18.
36 Sections 9A to 9I.
37 Subpart 6: Unreasonable fees.
38 Section 13.
39 Section 11.
40 Sections 15-21.

feedback once the Commission has concluded the first principles review and specific reform proposals have been developed in relation to a class actions framework and litigation funding model.

5.2 If the Commission has any questions or further discussion would assist, please do not hesitate to get in touch. The convenor of the Law Society's Civil Litigation and Tribunals Committee, Daniel Kalderimis, can be contacted via our Law Reform and Advocacy Advisor, Nilu Ariyaratne (Nilu.Ariyaratne@lawsociety.org.nz).

Nāku noa nā

Tiana Epati
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