Ashurst Australia
13 February 2013

Litigation Update

Litigation funding regulations overcome impact of High Court's findings in *Chameleon*

WHAT YOU NEED TO KNOW

- On 6 December 2012, the Federal Government made changes to the forthcoming *Corporations Amendment Regulation 2012 (No. 6)* ("Amendment Regulation"). The Amendment Regulation now declares that litigation funding schemes and arrangements **are** financial products, and **are not** credit facilities – overcoming the impact of the High Court's findings in *International Litigation Partners Pte Ltd v Chameleon Mining NL (Receivers and Managers Appointed)* [2012] HCA 45.
- The changes to the Amendment Regulation (set to commence on 12 July 2013) ensure that it will operate as originally intended, paving the way for litigation funders to carry on their business without the need for an Australian financial services licence or an Australian credit licence. Litigation funders will, however, be required to put in place arrangements to manage conflicts of interest.

WHAT YOU NEED TO DO

- From 12 July 2013, litigation funders (and lawyers involved in funded legal proceedings) will be required to manage conflicts of interest by:
  - conducting reviews of potential conflicting interests involved in litigation funding schemes or arrangements;
  - putting in place written procedures for identifying and managing conflicts of interest; and
  - reviewing such procedures every 12 months.

On 6 December 2012, the Federal Government made changes to the forthcoming *Corporations Amendment Regulation 2012 (No. 6)* ("Amendment Regulation"). The Amendment Regulation now declares that litigation funding schemes and arrangements **are** financial products, and **are not** credit facilities.

These changes were necessitated by *International Litigation Partners Pte Ltd v Chameleon Mining NL (Receivers and Managers Appointed)* [2012] HCA 45 ("*Chameleon*"), in which the High Court declared that a litigation funding agreement was excluded from the statutory definition of a "financial product" by virtue of it being a "credit facility". Effectively, the High Court's decision removed litigation funders from the scope of the Amendment Regulation, which applies to persons providing a "financial service". It also appeared that litigation funders might, in some circumstances, be required to hold an Australian credit licence ("ACL").

These difficulties have now been resolved. The Amendment Regulation will, upon its commencement on 12 July 2013, allow litigation funders to operate without holding an Australian financial services licence ("AFSL") or an ACL.[1] Litigation funders will, however, be required to put in place arrangements to manage conflicts of interest. In order to fulfil this obligation, they will be required to conduct a review of potential conflicting interests involved in a litigation funding scheme or arrangement, put in place written procedures for managing conflicts of interest, and review such procedures every 12 months.

[1] In the interim, ASIC has granted class order relief (CO 10/333) which exempts litigation funders from the need to hold an AFSL or ACL.

Chameleon: litigation funding agreement is not a financial product

Background
Chameleon Mining NL ("Chameleon") entered into a litigation funding agreement ("Funding Deed") with International Litigation Partners Pte Ltd ("ILP"), a litigation funder. A subsequent change in control of the Chameleon board triggered a clause under the Funding Deed that required Chameleon to pay ILP an "early termination fee" which exceeded $8 million. Chameleon disputed its obligation to pay, purporting to rescind the Funding Deed under s925A of the *Corporations Act 2001* (Cth) on the basis that ILP had carried on a "financial services business" without an AFSL as required by s911A of the Act.

The question of whether ILP required an AFSL turned upon the construction of Chapter 7 of the *Corporations Act* and the regulations made under the Act. The primary issue was whether the Funding Deed fell within the statutory definition of a "financial product" such that ILP could be said to be providing a "financial service" (see s766A(1)(b), s766C). This would mean that ILP was in the "business of providing financial services" and was therefore required to hold an AFSL.

Decision of the Court of Appeal
By majority, the Court of Appeal held that, prima facie, the Funding Deed met the statutory definition of a financial product because it was a facility which had as its main purpose the management of financial risk (per s763A). As to whether the Deed fell within the definition of a "credit facility" (such that it would be excluded from the definition of a "financial product"), the majority held that it did not. Their Honours found that ILP had promised to pay Chameleon's legal costs, but that it had not advanced money to Chameleon such that there was a debt owed by Chameleon which was deferred (per reg 7.1.06(3)(a)(i)).

Decision of the High Court
The High Court unanimously overturned the Court of Appeal's decision, holding that ILP did not require an AFSL because the Funding Deed answered the description of a "credit facility" and was therefore excluded from the definition of a "financial product". The Funding Deed, the High Court said, was a form of "financial accommodation" (reg 7.1.06(3)(b)(i)) whereby ILP promised to pay Chameleon's legal costs. The Funding Deed therefore met the definition of a "credit facility", even though ILP paid Chameleon's legal costs directly rather than advancing money to Chameleon to enable it to pay the costs on its own behalf.

Chameleon's consequences

Effect on the Amendment Regulation
Following the decision of the Court of Appeal in *Chameleon*, the Federal Government released the Amendment Regulation which, upon its commencement, was intended to:

- exempt persons providing a "financial service" in relation to a litigation scheme from the requirement to hold an AFSL (reg 7.6.01(1)(x)); and
- impose a new obligation on persons providing a "financial service" for a litigation scheme to manage potential conflicts of interest (reg 7.6.01AB(2)(b)).

However, following the High Court's decision, litigation funders appeared not to fall within the statutory definition of persons who provide a "financial service", and they therefore appeared not to be subject to the Amendment Regulation.

Question about Australian credit licences
Another consequence of the High Court's decision was that some litigation funders may have been required to hold an ACL under the *National Consumer Credit Protection Act 2009* (Cth). This is because the National Credit Code (contained within the Act) relevantly applies to the provision of credit to a natural person where the credit is for personal, domestic or household purposes. On the basis of the High Court's decision (namely, its finding that litigation funding agreements were "credit facilities"), some litigation funding agreements (for example, agreements entered into with claimants involved in personal injury actions), would likely fall within the terms of the Code.

Federal Government amends the Amendment Regulation

The above consequences have been overcome by the changes made to the Amendment Regulation in December 2012. The Amendment Regulation now declares – overcoming the impact of the High Court's decision in *Chameleon* – that a litigation funding scheme or arrangement, and an interest in a litigation funding scheme or arrangement:

- is a financial product (reg 7.1.04N); and
- is not a credit facility (reg 7.1.06(2A), (2B)).

This means that the Amendment Regulation can now engage s911A(2)(k) of the *Corporations Act*, which allows for the making of regulations which exempt a person from the requirement to hold an AFSL for a

"financial service" they provide. Forthcoming regulations 7.6.01(1)(x) and (y), made in accordance with s911A(2)(k), can now operate to exempt persons providing a service in relation to a litigation funding scheme or arrangement from the requirement to hold an AFSL.

Additionally, in declaring that a litigation funding scheme or arrangement is not a credit facility, the Amendment Regulation clarifies that litigation funders are not required to hold an ACL.

It is also now clear that litigation funders (and lawyers involved in the conduct of funded legal proceedings) will fall within forthcoming regulation 7.6.01AB(2)(b), which obliges persons providing a "financial service" in relation to a litigation funding scheme or arrangement to put in place arrangements to manage potential conflicts of interest. In order to fulfil this obligation, litigation funders and lawyers will be required to conduct a review of potential conflicting interests involved in a litigation funding scheme or arrangement, put in place written procedures for identifying and managing conflicts of interest, and review such procedures every 12 months (reg 7.6.01AB(4)). ASIC has also released a consultation paper outlining how such conflicts may be managed (*Litigation schemes and proof of debt schemes: Managing conflicts of interest*, August 2012).

Ashurst acted for International Litigation Partners Pte Ltd in the Chameleon proceedings at first instance, on appeal and before the High Court.

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