Insurance Council of New Zealand

Insurance Council of New Zealand
P.O. Box 474 Wellington 6140
Level 2, 139 The Terrace
Tel 64 4 472 5230
email icnz@icnz.org.nz
Fax 64 4 473 3011
www.icnz.org.nz

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Te Aka Matua o te Ture | Law Commission
PO Box 2590
Wellington 6140

By email: cal@lawcom.govt.nz

ICNZ submission on IP45 Class Actions and Litigation Funding | Ko ngā Hunga Take Whaipānga me ngā Pūtea Tautiringa

Thank you for the opportunity to submit on the *Class Actions and Litigation Funding Issues Paper* (Issues Paper), which was released by Te Aka Matua o te Ture on 4 December 2020.

By way of background, ICNZ's members are general insurers and reinsurers that insure about 95 percent of the Aotearoa New Zealand general insurance market, including about a trillion dollars' worth of Aotearoa New Zealand property and liabilities. ICNZ members provide insurance products ranging from those usually purchased by individuals (such as home and contents, travel and motor vehicle insurance) to those purchased by small businesses and larger organisations (such as product and public liability, business interruption, professional indemnity, commercial property and directors and officers insurance). As frequent defendants to litigation, and liability insurers for many defendants to class actions, as well as being consumers of litigation themselves, insurers are well-placed to comment on the advantages and disadvantages of class actions and litigation funding.

ICNZ welcomes this review and would be happy to engage further if it would be of assistance. Please contact Jane Brown (jane@icnz.org.nz) if you have any questions on our submission or require further information.

Submission

Our responses to the questions posed in the Issues Paper are set out below.

Q1. What problems have you encountered when relying on HCR 4.24 for group litigation?

ICNZ agrees with the problems relating to HCR 4.24 outlined in Chapter 4 of the Issues Paper. In our view the greatest problem with reliance on HCR 4.24 for group litigation is that cases proceed without clear rules meaning that there is lack of certainty and clarity. Judge-made law relating to HCR 4.24 is also slow to develop and piecemeal, given that it relies on proceedings completing the court process.

The rule also seems better suited to smaller proceedings where the interests of a class are clearly aligned. The rule does not seem entirely appropriate for large classes where each member's actions are attributed to the one representative plaintiff.

Q2. What kinds of claim are unlikely to be brought under HCR 4.24 and why?

Given how general and broad HCR 4.24 is, it is difficult to envisage there being any type of claim that is unlikely to be brought. Any group of people with the same factual or legal issue could bring a claim under the rule.

Q3. What do you see as the advantages of class actions? In particular, to what extent do you think class actions are likely to:

- ***a. improve access to justice?***
- ***b. improve efficiency and economy of litigation?***
- ***c. strengthen incentives to comply with the law? Is this an appropriate role for a class actions regime?***

Class actions, and funded class actions in particular, can improve access to courts for litigants who, for financial or other reasons (such as vulnerability), may not otherwise engage in proceedings. But whether such a regime will also improve access to justice is debateable, particularly as class actions in Aotearoa New Zealand are likely to have litigation funder involvement, so only those with profitable claims, rather than those of public interest (which are unlikely to have the same monetary value), will be pursued. It should also be noted that it is unlikely that a class actions regime will benefit or improve access to justice to people with low financial literacy or low socio-economic status, as it will not provide any additional incentive to engage with the legal system. On this point, we note the comment in paragraph 6.54 of the Issues Paper from Jasminka Kalajdzic that class actions have been described as "providing justice for the middle class rather than the poor".

A controlled class actions regime, with appropriate controls over litigation funders, as will be outlined later in this submission, is preferable to the representative action rule for class actions from an insurer perspective, as it would provide greater certainty in terms of process. We note however, that if not adequately addressed via mechanisms such as the adverse costs rule, a class actions regime could lead to an increase in speculative litigation that may then have a flow on effect to the availability and affordability of D&O insurance.[1]

We do not necessarily agree that a class actions regime will improve economy of litigation. Litigating class actions is incredibly expensive and it is unlikely that the same amount would be spent litigating individual causes of action. A class actions regime also does not mean that defendants will not face multiple claims from different plaintiffs with related causes of action. For example, there are two funded competing representative actions underway in relation to CBL Insurance following its collapse.

We do not believe that class actions are likely to strengthen incentives to comply with the law as there appears to be little conclusive evidence globally to this effect. While a class actions regime may provide some incentive to comply with the law (or deterrence to not complying with the law), this is likely to be an incidental effect. If the objective of a class actions regime is to strengthen incentives to comply with the law, it would likely need to be structured differently than a regime aimed at increasing access to justice. We therefore suggest that it would not be desirable to pursue a goal of strengthening compliance unless there is substantial evidence that class actions are an

[1] See the Institute of Directors' *Under Pressure – D&O insurance in a hard market* Trends and insights report, September 2020 or AM Best's Market Segment Report *Accelerating Trends, Unprecedented Turmoil Could Lead to Seismic Change for D&O Industry*, June 10 2020.

effective mechanism for achieving this end. We instead believe that the role of providing incentives to comply with the law should be left to the appropriate regulators, whose litigation decisions are driven by guidelines designed to reflect the public interest, as is currently the case. If this model is not working satisfactorily then other options should be pursued rather than allowing enforcement action to be driven by litigation funding organisations which have a profit motive.

Q4. Do you have any concerns about class actions? In particular, do you have concerns about:

- ***a. the impact on the court system?***
- ***b. the impact on defendants?***
- ***c. the impact on the business and regulatory environment?***
- ***d. how class members' interests will be affected?***

ICNZ agrees that class actions have the potential to impact negatively on the court system, on defendants, and on the business and regulatory environment. It also could provide insufficient protection of class members' interests. Specifically:

a. Impact on the court system: if a class actions regime increases group litigation, as is the aim, then the court system will be placed under increased pressure and it is likely that more funding will be required in order for the regime to operate efficiently and without undue delay.
b. Impact on defendants: from an insurance perspective, we are concerned that defendants will be negatively affected by the cost of defending litigation, either against themselves or against defendant insureds, especially given that even if successful, insurers will only be able to recoup around half of the actual costs involved in defending a class action. This may mean that insurers are under pressure to settle unmeritorious claims for financial reasons which will increase their overall costs.
c. Whether the regime is opt-in or opt-out will also have an impact on defendants. Our views on this point are discussed in more detail below.
d. As well as having a general public interest test at the certification stage of a class action (discussed in more detail below), we believe that the standard requirement for adequately particularised pleadings should continue to be strictly applied in class actions. This will enable strike out proceedings to be an effective recourse when pleadings are not sufficient. A further point which will need to be clarified for both defendants and plaintiffs, is whether settling with a closed class estops further individual actions. The removal of the right to sue for other claimants is significant and a point on which clarity is required.
e. Impact on the business and regulatory environment: it appears likely that enabling class actions will increase the cost of doing business via an increased risk of litigation and subsequent increase in insurance premiums. We understand that current statistics show that the losses arising from directors and officers (D&O) claims has exceeded the total insurance market premium pool by a significant margin.[2] Because of this, insurers are having to increase D&O premiums and will likely continue to do so with a proliferation of class actions.
f. Class members' interests: the majority of ICNZ's concerns around class members' interests centre on the involvement of litigation funders and are addressed in response to the questions on funders below.

[2] Ibid.

Q5. Should Aotearoa New Zealand have a statutory class actions regime? Why or why not?

ICNZ agrees that Aotearoa New Zealand should have a statutory class actions regime, in preference to ad hoc development of the law governing representative actions, for the following reasons:

1) Creating a statutory regime is a democratic, public policy-driven process better suited to dealing with the substantial objectives and rights involved in class actions, than incremental common law development.
2) There is effectively already a class actions regime by default under HCR 4.24. The implementation of a comprehensive and certain statutory framework for class actions with appropriate regulation and controls is far preferable to the uncertainty caused by HCR 4.24.
3) A statutory framework should tie in with other legislation, such as the Consumer Guarantees Act, and with statutory bodies such as the Financial Markets Authority (FMA) or a new regulator, which should have a conduct oversight role where litigation funders are involved.
4) A well-designed statutory regime is more likely to achieve a balance between the interests of those with a stake in the process (plaintiffs, defendants, litigation funders, etc.).

Q6. Should a class actions regime be general in scope or should it be limited to particular areas of the law?

We believe that a class actions regime should be general in scope and cannot see a reason for such a regime to be limited to particular areas of the law. However, if judicial review proceedings were to be included in the regime, it would be essential for a certification test to include whether a class action is the preferable approach.

Q7. Should a class actions regime be available in the District Court, Employment Court, Environment Court or Māori Land Court?

In ICNZ's view, class actions should be limited to the higher courts (ie. the High Court and above) as the cost would be oppressive in the likes of the District Court and Māori Land Court, and would cut across the specialised interests and jurisdictions which these other courts provide for.

Q8. Should a class actions regime include defendant class actions?

ICNZ believes that defendant class actions are necessary as there will be situations where they will help to increase the economy and efficiency of litigation. However, to ensure that a class action is the most appropriate way to litigate, we believe that, on the application of any defendant in a multiple defendant action, the court should assess whether the litigation should be treated as a class action and also require the plaintiff to go through a certification process. Furthermore, to ensure a workable defendant class action regime, if only one defendant is named in an action and it becomes a class action via the joinder of others, the law should specify that the additional defendants cannot, once joined, opt out.

Q9. Should the representative actions rule be retained alongside a class actions regime? For which kinds of case?

ICNZ believes that the representative actions rule should be retained, but reformed and limited in its use, with clear boundaries established between it and the class actions regime. In our view, the High Court Rules should be amended so that HCR 4.24 can only be used in situations where there are a small number of applicants, or where non-monetary relief is sought, without the involvement of a litigation funder. We agree that the court should retain the discretion to decide if a representative or class action is preferable by applying specific criteria, so that representative actions are not used as an attempted means of avoiding the requirements for class actions.

Q10. What should the objectives of a statutory class actions regime be? Should there be a primary objective?

In our view, the primary objective of any class actions regime should be to provide access to the courts to classes of plaintiffs who would otherwise struggle to obtain access to justice. In doing so, the regime should:

- enable class claims that are primarily compensatory in nature,
- enable claims where the amount of compensation being sought on behalf of class members is meaningful,
- enable claims brought primarily on behalf of willing class members who make an active decision to participate,
- enable claims that are in the public interest,
- protect defendants from unmeritorious or nuisance claims, and opportunistic claims without proper pleadings, and
- ensure that defendants facing class actions have adequate protection for their legal costs of defending unsuccessful claims.

This will help to improve the economy and efficiency of litigation. A class actions regime should not, however, unduly sacrifice rights of defendants in order to provide the access to justice. Other objectives should therefore be to balance the interests of plaintiffs and defendants, and to provide clear guidance to the courts on the oversight of litigation funding and the management of the inherent conflicts of interest that exist in funded litigation.

While we recognise that improved incentives to comply with the law may be a by-product of the introduction of a class actions regime, as earlier indicated, we do not believe it should explicitly be one of the objectives. Incentivising compliance with the law is an objective better suited to regulators, whereas class actions fulfil a compensatory function for aggrieved third parties within the adversarial context of the courts.

Q11. Which features of a class actions regime are essential to ensure the interests of plaintiffs and defendants are balanced?

We agree with the matters that are likely to be important to plaintiffs and defendants in paragraphs 9.13 and 9.14 of the Issues Paper. However, we note, in response to the assertion in 9.13 that any class actions regime must provide safeguards so that a well-resourced defendant cannot wear down plaintiffs with unnecessary procedural steps, that the converse must also apply. A well-resourced plaintiff, which is likely to be the case when a litigation funder is involved, equally has the ability to

wear down a lesser defendant. We do not believe that protections should be developed on the assumption that the defendant will always be the bigger and better resourced party.

Most notably for defendants, having a clear idea of the potential scope of liability and ensuring the plaintiff can pay an adverse costs award will be necessary to provide balance. It is possible that a class action will result in a disproportionate cost on the defendant. Whereas the costs to the representative plaintiff can be shared between class members or paid by a litigation funder, the defendant must pay the cost of proceedings itself, which will often be far greater than non-class action proceedings due to the size of the litigation. While it could be argued that this position is only fair when a defendant has acted unlawfully or in bad faith, the overseas experience shows that class actions commonly follow regulator action or catastrophic events where it is sometimes not so much about bad behaviour, but the opportunity for litigation funders to profit. In Australia, where a class actions regime has been in operation since 1992, the Parliamentary Joint Committee on Corporations and Financial Services ("Australian PJCCFS") released its 450-page report in December 2020 after an extensive consultation period during which the Committee received 101 written submissions from a range of industry, government and other participants, and held five days of public hearings in July and August 2020. The report recommends sweeping reforms to the regulation of litigation funders and plaintiff firms and to the class actions regime more broadly. The recommendations seek to better reflect the original objectives of the class actions regime to restore access to justice, promote the interests of group members, and, relevantly, to "deter opportunistic entrepreneurialism in the class actions space".[3]

We believe that certification will also be important to balancing the interests of the parties. We consider that the principle, as stated by the Alberta Law Reform Institute, that "plaintiffs be able to bring deserving claims and defendants should be protected from undeserving claims"[4] is a good one, when applied broadly. This is because, given that many class actions are litigation funded, there is a danger of claims that, although profitable for a funder, especially based on aggregating a small loss over a large number in a class, are not worthwhile or in the public interest. For example, if a bank unintentionally overcharged its four million customers $5 each, then the possible total recovery may appeal to a funder. But it is questionable whether it is in the public interest to commence class proceedings over this issue when there are other courses of action that may be more appropriate to compensate the customers, such as lodging a complaint with the relevant regulator about this conduct and allowing them to seek compensation on the customers' behalf. Further, if the bank had taken action to recompense customers and prevent a recurrence this ought to detract from the merits of any class action.

Q12. Which features of a class actions regime are essential to ensure the interests of class members are protected?

Careful management of both funding agreements and conflicts of interest by overriding court supervision will be essential for protecting plaintiff interests and ensuring defendants are not burdened with defending litigation that is primarily focussed on profiting litigation funders. There should also be a duty on the lawyer acting for a class to fully explain the class action process to

[3] https://www.allens.com.au/insights-news/insights/2020/12/final-report-on-litigation-funding-and-class-actions/

[4] Issues Paper, paragraph 9.12.

individual members so that they are able to participate where necessary and feel that they have the ability to voice any concerns.

Q13. Is proportionality an appropriate principle for a class actions regime? If so, what features of a class actions regime could help to achieve this?

We consider that proportionality is an essential principle to ensure that time and resources are not wasted, and to prevent class action proceedings where the time and expense is out of proportion to the outcome sought. To achieve this, there should be a general assessment at the certification stage of proceedings of whether or not the claim is meritorious. To this end, we consider the United States reform proposal to be of value, so that judges have to consider in certification criteria the cost and benefit of proceeding via a class action, and "whether the probable relief to individual class members justifies the costs and burdens of class litigation".[5]

Q14. Are there any unique features of litigation in Aotearoa New Zealand that need to be considered when a class action regime is designed?

While not a design feature, it should be noted that the small population of Aotearoa New Zealand may make a class actions regime harder to justify financially and may be impacted by lack of interest from litigation funders except in cases where high returns are expected. This may mean that the objective of access to justice is not achieved when the claim relates to a matter of public interest with low, or no monetary value.

Q15. To what extent, and in what ways, should tikanga Māori influence the design of a class actions regime?

We believe that Te Aka Matua o te Ture should undertake a targeted consultation with various Māori representative bodies to ensure that any class actions regime is going to also meets their needs. It is essential that the rules accommodate the unique socio-cultural aspects of collective decision-making, when looking at participant protections, in a litigation funded class action involving Māori interests. For example, consideration of whakapapa, whanaungatanga and mana could be applied to the selection of a representative plaintiff.

Q16. Do you have any concerns about how a class actions regime could impact on other kinds of group litigation or on regulatory activities? How could such concerns be managed?

ICNZ is more concerned about the impact of regulatory activities on class actions rather than vice versa. As overseas experience shows, litigation funded class actions tend to follow closely behind regulatory action, such as the many examples in Australia where proceedings have been commenced following investigation into possible breach of the continuous disclosure obligations under their Corporations Act 2001 (which it has recently been announced is to be permanently amended, partly on the basis that it is recognised as one of the drivers of increasing D&O premiums). One way to manage these concerns could be to require a stay of any civil class actions unless and until the regulatory process (litigated or otherwise) has been completed. This would ensure that there is no duplicative waste of resources and would also prevent speculative class actions being

[5] Issues Paper, Chapter 9, paragraph 9.28.

filed by an opportunistic litigation funder seeking to benefit from a regulator's processes, or being able to put undue pressure on a defendant to settle a claim in order to avoid challenges on multiple fronts. If the regulator's processes (or voluntary recompense by the defendant) did not sufficiently address legitimate claims by impacted third parties, then the class action for the balance of the claims could proceed, but the substantive issues (including liability) would be dealt with in just one proceeding.

ICNZ considers that, rather than an overly broad and permissive statutory class actions regime, detailed consideration should be given to conferring new or expanded roles on regulators with respect to collective redress including to enable compensation for consumers who have suffered harm. This would avoid unnecessary costs of litigation and dilution of the proceeds of successful claims via payments to lawyers and funders, especially where businesses are willing to provide voluntary redress.

Q17. Which issues arising in funded class actions need to be addressed in a class actions regime?

In addition to the issues raised in paragraph 9.49 of the Issues Paper, we strongly believe that the issue of the possible trade in litigation needs to be addressed. There need to be controls to ensure that litigation funders do not hold an unreasonable level of control of litigation or receive an unacceptably high proportion of any settlement proceeds. We believe that a discussion needs to take place to decide what adequate compensation for victims is, in the context of litigation funding. The controls should also include discovery of the litigation funding agreement in the same way that the existence of legal aid is disclosable, and the court should have the ability to amend the funding agreement if they deem it necessary to protect the interests of the class members. In the Australian PJCCFS, the committee found that group members have generally received reduced compensation, compared to 'generously paid' plaintiff lawyers and litigation funders.

Q18. Do you agree with our list of principles to guide development of a class actions regime?

We agree that the principles at paragraph 9.2 of the Issues Paper are broadly appropriate for a class actions regime.

Q19. Should a class action regime include a certification requirement? If not, should the court have additional powers to discontinue a class action (as in Australia)?

ICNZ believes that a certification requirement is vital to the operation of a fair and balanced class actions regime and should act as a gatekeeper to protect the interests of defendants, whose reputational and financial position may suffer damage as soon as a class action is commenced. The certification should ensure that:

1. The proceedings raise claims that are arguable 'as a matter of law'. We do not believe that this should be a particularly high threshold. In particular, 'novelty' or the lack of existing precedent should not be barriers to proceedings.
2. The pleadings have been sufficiently particularised (including in respect of causation and loss) so that the defendant is able to fully understand the nature of the case against them.
3. The factual assertions have a reasonable evidential basis. This is necessary to prevent speculative proceedings founded on unsubstantiated allegations. This should be an

evaluative process that takes into consideration evidence from the defendant which tends to refute allegations that lack an evidential basis.

4. The class action is proportionate. As already stated at question 13, there should be an assessment at the certification stage to ensure that the time and expense of the litigation is not out of proportion to the outcome sought.
5. The claim is worthwhile and in the public interest. As already stated at question 11, this is to ensure that plaintiffs are able to bring deserving claims and defendants are protected from undeserving claims.
6. The common issue is identified.
7. The group is sufficiently numerous.
8. Any litigation funders are properly identified, and appropriate arrangements are made to secure compliance with any adverse costs orders.
9. Conflicts of interest are identified and managed.
10. The identification and consolidation of competing class actions is achieved.
11. The court can approve a litigation plan for the orderly prosecution of the claim.
12. The court can approve any funding arrangements to ensure they are fair and just. That might involve, in the case of an opt-out arrangement, a 'contradictor' to test the applicants' assertions. In the context of insurer-led class actions, such as subrogated recoveries for multiple litigants, there is considerable advantage to court approval of cost sharing arrangements where the recovery involves excesses, insured and uninsured losses.

Q20. Should a class actions regime contain a numerosity requirement? If so, what should this be?

We believe that there should be a numerosity requirement as part of the certification requirement and see benefit in following the US approach where the test is whether "the class is so numerous that joinder of all members is impracticable".[6] This would effectively restrict class actions to 'true classes' rather than a manageable group of litigants. Additionally, defending a class action carries with it a real stigma of alleged widespread or systemic wrongdoing, accompanied by a fear or large, but unquantifiable, financial exposure. The consequences of being a class action defendant should not be borne by defendants who would be more appropriately, or more easily, pursued via actions brought (either individually in multiple actions or together in consolidated actions) by individually named plaintiffs.

Q21. Should the commonality test that applies to representative actions under HCR 4.24 apply to a class actions regime? If not, how should this test be amended?

We do not believe that the commonality test that applies to representative actions under HCR 4.24 is a sufficiently high threshold to also apply to class actions. We agree with the views of the Rules Committee in 2019 who stated that members of a representative group should have a common interest "in the determination of some substantial issue of law or fact"[7], which in our view, would be a more robust test than that under HCR 4.24. Generally speaking, commonality should mean that the issue is dispositive of liability as between all members and the defendant, rather than going to quantum. This will ensure that a defendant will not be deprived of a defence that would have been

[6] United States Federal Rules of Civil Procedure, r 23(a)(1).

[7] Rule 4.74(a) of the Draft High Court Rules (Representative Proceedings) Amendment Rules 2019 (PCO 20692/4.2)

available in individual proceedings or confer rights of action on class members that they otherwise would not have.

Q22. Should a representative plaintiff have to establish that the common issues in a class action are substantial or that they 'predominate' over individual issues?

We believe that representative plaintiffs should be required to establish that the common questions predominate over any questions only affecting individual class members in order to establish that the claims are sufficiently cohesive to warrant a class action.

Q23. Should a representative plaintiff have to establish that a class action is the preferable or superior procedure for resolving the claim?

We believe that, assuming the numerosity requirement has been satisfied, superiority should only be considered if the class action:

1) follows on from extant non-class action proceedings involving the same defendant and the same issues, the key issue being the desirability of a class action running in tandem with an individual claim. In this regard, the court should have the power to either stay individual proceedings or order a joinder to a class action, or
2) where the class action is opt-out. Opt-out proceedings will effectively remove the plaintiff from their right to bring, control, and settle their own proceedings.

Proving superiority in these circumstances will also help to ensure that the high transaction costs of a class action are worth incurring and that alternative mechanisms are not more appropriate. The matters the court takes into account when considering if a class action is preferable or superior should include the criteria used in the US, outlined at paragraph 10.51 of the Issues Paper, as well as whether class actions are "an appropriate means for the fair and efficient resolution of the common issues".[8]

Q24. Should a court be required to conduct a preliminary merits assessment of a class action or an assessment of the costs and benefits?

ICNZ strongly supports a preliminary merits assessment. This type of assessment will act as a necessary gateway to weeding out clearly meritless claims and greatly assist the parties to better understand their litigation risk, which may lead to earlier settlements. We also believe that there is value in a cost/benefit analysis. Such an assessment may prevent class actions where, for example, identifying class members and distributing payments would be excessive and disproportionate; or where legal costs are likely to be disproportionate to any damages award. These mechanisms should not be any impediment to worthwhile, well-particularised class claims.

Separate to a preliminary merits assessment and a cost/benefits analysis, we propose that there should also be a 'public interest' test. This test could consider whether a class action is the best avenue for compensating individuals or whether the action would be best brought by a regulator or other entity. For example, the FMA has the ability to seek compensation on behalf of affected persons (in addition to civil pecuniary penalties) under the FMCA. Therefore, where a securities class action is brought alongside a claim by the FMA (for example, the two class actions against CBL

[8] The Competition Appeal Tribunal Rules 2015 (UK), r 79(2)(a).

Insurance), this would allow for a finding that the claim for shareholder compensation would be best brought as part of the FMA claim so as to avoid both (i) additional burden on the defendant of defending multiple claims concerning the same subject matter, and (ii) dilution of the proceeds to shareholders from any recovery through lawyers' fees and funder's share.

Q25. Should a representative plaintiff be required to provide a litigation plan?

ICNZ supports representative plaintiffs being required to provide a litigation plan as part of the certification process. The onus being on the plaintiff to present the plan, and the court's expectation that the parties will, where possible, cooperate in its formulation, will serve a number of purposes. Firstly, the process is likely to draw out the necessary information for the court to evaluate numerosity, commonality, and, where relevant, superiority. Secondly, the process will assist the parties to better understand the costs and resources needed for the case. Such an understanding might be relevant to setting reserves for the proceedings and is important to assess the risks, costs and benefits for settlement negotiations. Finally, a litigation plan would be useful for the judge who has been assigned management of the proceedings, particularly when dealing with any interlocutory applications.

We also agree that, as with the Canadian regime, there should be an ability for the court to adjourn the certification application pending the submission of a satisfactory plan. This is because the lack of an adequate plan may cause delay, to the detriment of both the plaintiff and the defendant. In our view, the matters to be included in the plan should be prescribed, and the court should then have a discretionary power to set additional requirements as they see fit depending on the cause of action and parties to the proceedings. The prescribed content for a litigation plan should include setting out how costs, such as adverse costs will be paid, the conduct of the litigation between the parties, and governance of the claim as between the litigation funder, the legal representative of the class, and the class members.

Q26. Should a court consider funding arrangements as part of a threshold legal test for a class action?

ICNZ strongly agrees that a court should consider funding arrangements as part of the threshold legal test for a class action. Key concerns in this space include preventing litigation which is of virtually no benefit to plaintiffs, ensuring that the funding agreement will not diminish the plaintiff's ability to instruct their lawyer or control the proceedings, and ensuring that the funder can satisfy an adverse costs order to the extent required in the indemnity to the plaintiff. To this end, as part of the certification process, the court should be apprised of the identity of the funder, the propriety of arrangements between the funder, lawyer and class members, and be satisfied that the funder would provide adequate security for costs.

We do not however, believe that it should be left to the court to consider whether a funder's commission is reasonable as this assessment is unlikely to be within their expertise. As stated elsewhere in this submission, we believe that there should be a prescribed cap on funder commission as well as regulator supervision of litigation funders.

Q27. Should a statutory class actions regime have any other threshold legal tests?

We consider that there should be two other threshold tests. Firstly, where a funder is involved, security for costs should be granted as of right, unless there are exceptional circumstances for not granting the order, with the onus on the funder to prove the exceptional circumstances. In our view, certification should not be issued until the security has been provided. We note that Australia's PJCCFS has recommended that their Federal Court of Australia Act 1976 be amended to include a statutory presumption that a litigation funder in a class action provide security for costs.[9] Secondly, a defendant should also be entitled to seek an order for joinder of other defendants, or joinder as third parties as a condition of certification. While a class of litigants should be permitted to choose the issues to be adjudicated by the court, they should not be able to limit possible defendants to one party only, when others would be liable on the same facts presented.

Q28. Should a court consider the representative plaintiff's suitability for the role as part of the threshold legal test for a class action? If so, what should the criteria be?

ICNZ agrees that the court should consider the representative plaintiff's suitability for the role, and supports the criteria outlined in the Issues Paper, including the need to manage conflicts of interest between the representative plaintiff and other class members, ensuring the representative plaintiff understands the role they are taking on, and ensuring that the representative plaintiff has sufficient financial resources. From a defendant's perspective, it is particularly important that the representative plaintiff will be a competent litigant with an adequate understanding of civil procedure and sufficient financial resources to pay an adverse costs order. It is also important to ensure that there are no conflicts of interest – for example, where the plaintiff is a member of the law firm which seeks to act for the class.

Q29. Should a representative plaintiff be a class member or should ideological plaintiffs be allowed?

We believe that the representative plaintiff should be a class member, however we also agree with the comments made by Her Honour, Justice Glazebrook, outlined in paragraph 11.28 of the Issues Paper, that a more flexible approach may be justified as to who may be the representative plaintiff in claims of breach of Crown duty to Māori.

Q30. When should a government entity be able to bring a class action as representative plaintiff?

ICNZ believes that the FMA and Commerce Commission already have sufficient powers to bring class actions. In our view, other government entities should only be able to bring class actions when provided by statute or they have their own claim. We note that we do not object to a government entity having a role of intervener where issues of public importance arise in a class action.

[9] Parliamentary Joint Committee on Corporations and Financial Services, *Litigation funding and the regulation of the class action industry*, December 2020, Recommendation 10, page 143.

Q31. When a plaintiff wants to represent the interests of a whanau, hapū or iwi, should the court inquire into their suitability to represent the group in terms of tikanga Māori?

We agree that the court should inquire into the suitability of a plaintiff where they intend to represent the interests of a whanau, hapū or iwi, and reiterate the comments made in response to question 29 above, that there should be flexibility in the approach to who may be the representative place in a case involving Māori interests.

Q32. Should class membership be determined on an opt-in basis or an opt-out basis or should different approaches be available?

ICNZ considers that class membership should be determined on an opt-in basis. In doing so, with respect, we disagree with many of the Court's findings in the *Ross v Southern Response* decision, including that requiring the plaintiff to take active steps to participate in proceedings is an "unnecessary hurdle" which deprives them of their ability to access the courts.[10] A well-functioning opt-in system does not create unnecessary hurdles and promotes plaintiff autonomy. Additionally, we believe the Court in *Ross* did not adequately consider the significant difference in the economics of opt-in and opt-out class actions, nor the significant burden placed on defendants to opt-out class actions, who are forced to consider how to respond to claims of an indeterminate size.

General points in favour of opt-in class membership include:

- Opt-in proceedings require the express informed consent of the class which favours plaintiff autonomy and ensure that only those who wish to participate in the class action are joined.
- Opt-in proceedings would help to prevent the commencement of speculative actions on behalf of large classes when only a small number of people are actually motivated to participate.
- Opt-in proceedings are less likely to require court oversight due to participants having actively opted in and will therefore be less onerous on the court's resources.
- Opt-in proceedings are not such a burden on the defendant in that they are able to more accurately assess the claim against them.
- Aotearoa New Zealand is a small country and the likelihood of not being able to locate class members, which possibly provides some justification for opt-out proceedings, is low.

We also note that, from an insurance perspective, the combination of an opt-out class actions regime and the rise of litigation funding is likely to significantly increase the risk for general liability and D&O insurers. Of particular risk, are actions flowing from large-scale catastrophe events, and public liability issues such as those involving faulty cladding and climate change impacts. This combination could have a negative effect on the availability or affordability of insurance for consumers.

The only point in favour of opt-out proceedings that ICNZ is aware of, is that there is finality because the decision is binding on anyone in the class of potential plaintiffs, and not just those who participated in the proceedings. Arguably however, this then raises issues of fairness where, despite best efforts being made, a potential plaintiff was unaware of the proceedings and then has no legal recourse to pursue. This benefit could also be achieved in opt-in proceedings if there were rules

[10] *Ross v Southern Response Earthquake Services Limited* [2019] NZCA 431 [16 September 2019] at [98].

introduced to ensure that there is some form of estoppel after an opt-in class action to ensure finality for the defendant.

Q33. If the court is required to decide whether class membership should be determined on an opt-in, opt-out or universal basis, what criteria should it apply? Should there be a default approach?

We do not believe that there should be a default approach. As per *Ross v Southern Response*, it is a matter of considering what will best meet the objectives of the action in the particular case. For example, where proceedings relate to a matter where each class member has the exact same interest (such as being overcharged a particular fee), an opt-out approach may be appropriate. However, in more complex proceedings such as those involving insurance, while the claims may arise from the same set of circumstances (the same event or use of the same product, for example) the specific facts and policy wordings would mean that an opt-in class action would be more suitable. The practicability of the different approaches for the particular proceedings should be a criterion. However, if there must be a default option, we consider that it should be opt-in. Aotearoa New Zealand's small size means that the difficulties in notifying and obtaining consent of potential class members that are encountered in larger jurisdictions, which, as stated above, may give some justification to opt-out proceedings, do not arise. Opt-in proceedings are also easier to manage in terms of funders and lawyers being able to obtain agreement from all class members to their terms of service. Opt-in proceedings are also preferable for defendants because potential liability can be more easily assessed and quantified.

Q34. How has the risk of adverse costs impacted on representative actions?

It is likely that the presence of the adverse costs rule has meant that only those representative actions with merit have been pursued, as the risk to the representative plaintiff would otherwise be too great.

Q35. Should the current adverse costs rule be retained for class actions or is reform desirable?

ICNZ supports retaining the adverse costs rule as this will provide a check on unmeritorious claims and ensure consistent application of the law. The adverse costs rule justly compensates the successful party, encourages settlement through Calderbank offers, discourages speculative litigation, and addresses some of the potential imbalance in favour of class members who are well resourced and funded. A one-way cost shifting rule would be extremely unfair and prejudicial to defendants. Such a rule would appear to assume that merely because there has been a claim filed in court, that the defendant is blameworthy. Despite these views, we would be happy to see an exception to the adverse costs rule apply for class actions in the public law area that do not involve monetary claims, such as in judicial review matters.

In our view, as well as retaining the adverse costs rule, there should be a new scale of costs developed specifically for class actions to reflect their size/complexity and the increased time and expense it takes to complete each step in the litigation process.

Q36. Are there any other issues associated with class actions that we have not identified? Is there anything else you would like to tell us about class actions?

We believe that there should be an additional power to discontinue a class action to enable the Court to address issues as they arise during the course of the litigation, which means it may no longer be appropriate as a class action or it is otherwise in the interests of justice to do so.

Q37. Which of the potential advantages and disadvantages of permitting litigation funding do you think are most important, and why?

ICNZ considers the following advantages and disadvantages of permitting litigation funding to be important:

- Litigation funding may allow access to litigation for smaller plaintiffs who would not otherwise have access to the courts. However, experience shows that returns from such litigation tend to be heavily weighted towards the funder, raising the issue of the court's processes being used for profit-making under the guise of access to justice. An increase in funded proceedings may also increase the courts' workload and impact on resources, delaying access to justice.
- There is an obvious concern with the current level of financial stake a litigation funder may have in proceedings given that there is no regulation, and the courts seem reluctant to intervene. It is understandable that a funder will want to protect their investment in the proceedings, but as is pointed out in paragraph 6.61 of the Issues Paper, Australian data shows that the median return to class members in a funded action is only 51%, compared with 85% in non-funded actions.
- Other than just having an impact on D&O insurance premiums, it is possible that general insurance policies that provide public and product liability cover may also be negatively affected as a result of the increased risk from class action exposures (as has been seen in Australia with various bushfire class actions and the Wivenhoe Dam class action).
- A rise of litigation funding is a risk for D&O and general liability insurers as it could incentivise action due to (a) large-scale catastrophe events, and (b) large-scale customer remediation by insureds as a result of regulator action, albeit sometimes in the context of small losses by numerous customers such as fees deemed to be penalties against the banks.
- A D&O policy is effectively the cause of claims because litigation funders chase the D&O policy where the action derives from a failure by its officers, for example where there is a regulator investigation.
- Entities perceived to be particularly exposed to regulator or shareholder action can find buying D&O insurance increasingly difficult and expensive.
- Given existing law around joint and several liability, Aotearoa New Zealand runs the risk of driving perverse outcomes where entities and directors are in a worse position where they have D&O cover. Where defendants are jointly liable, the insured person or entity becomes a target as "last man standing", with insurance cover being seen as the deepest pockets of all the defendants.

We also note and disagree with the comment in paragraph 17.8 of the Issues Paper that litigation funding may bolster the credibility of the plaintiff in proceeding to trial on the basis that the merits have been assessed by a third party, or that litigation funding itself provides assurance that the plaintiff will be able to meet an adverse costs award. The Canterbury earthquake experience,

including the *Bligh v Earthquake Commission*[11] cases, demonstrate that sometimes the fact that there is litigation funding means that cases proceed without a proper assessment of their merits until the litigation funder withdraws, potentially at the last minute. Some litigation funders may proceed on the assumption that a well-resourced corporate defendant will pay a "departure tax" to end proceedings and avoid the higher irrecoverable cost of winning at trial. This can be disastrous for plaintiffs and defendants, who are left to bear the costs of such unmeritorious proceedings. Insurers have also experienced situations where earthquake proceedings were commenced on the basis of a hope that the claim would end up over the EQC cap (being the limit the Earthquake Commission pays for natural disaster damage to residential properties, which at the time of the Canterbury earthquakes, was $100,000+GST). Once the parties had finalised their engineering and costings it would then become apparent that the claim was clearly under cap. The funder would then pull out of the litigation, leaving the insured stuck in proceedings from which they were unable to extract themselves or have to pay their own and the defendant's costs to discontinue.

It is also questionable whether litigation funding necessarily promotes worthwhile claims. Paragraph 17.13 of the Issues Paper says that in the year to 13 June 2019, 16 consumer class actions were filed in Australia, 72 percent of which were filed by litigation funders, including claims of modest individual value. As a litigation funder is profit driven, it will look to claims where the aggregate amount is profitable, whereas the individual harm may be relatively negligible. We consider that such litigation is often not worthwhile or in the public interest and that at certification stage there should be an assessment of whether the claim is in the public interest. This should be a separate assessment from a merits assessment which focuses on whether or not a cause of action can succeed.

Q38. Is litigation funding desirable for Aotearoa New Zealand in principle?

ICNZ considers that litigation funding is desirable in principle, from the perspective of enhancing access to justice, but cautions that such arrangements will need to operate within clear and strict parameters. We also reiterate the adverse consequences funded class actions have had on the availability and affordability of D&O insurance in Aotearoa New Zealand and Australia, in particular.

Q39. To what extent, if any, do the torts of maintenance and champerty impact on the availability and pricing of litigation funding in Aotearoa New Zealand?

We are not aware of any impact due to the torts of maintenance and champerty given that there has been no reported case of a successful claim in tort relying on them.[12]

Q40. Should the courts be left to clarify and develop the law in relation to maintenance and champerty, or should the law in relation to maintenance and champerty be reformed?

Statutory reform of the torts would provide greater clarity to their application. The overriding principle that court processes should not be used by an unrelated third party to profit should be retained in some form, with specific rules relating to litigation funding. The courts' current reluctance to interfere with a commercial litigation funding agreement needs to be redressed.

[11] *Bligh v Earthquake Commission & IAG* [2018] NZHC 2102 [16 August 2018].
[12] Issues Paper, paragraph 18.22.

Q41. If reform is required, which option for clarifying the law do you prefer and why? For example, should the torts of maintenance and champerty be:

- ***a. retained, subject to a statutory exception for litigation funding?***
- ***b. abolished?***
- ***c. abolished, subject to a statutory preservation of the courts' ability to find a litigation funding agreement unenforceable on grounds of public policy or illegality?***

Without a full understanding of the wider impact of abolishing maintenance and champerty, we suggest a cautious approach to this question is preferable. We support retaining the torts, subject to a statutory exception for litigation funding. In drafting the statutory exception, it will be important to include wording to the effect that nothing affects the power of the court to prohibit or control an action that constitutes an abuse of the process of the court.[13]

Q42. What concerns, if any, do you have about funder control of litigation?

Given the additional burden on defendants and insurers by funded litigation, we believe that funder control of litigation needs to be closely supervised to ensure that such litigation is worthwhile. Regulation will also be required to protect plaintiffs. The public policy reason for allowing litigation funding agreements, despite the existence of the torts of maintenance and champerty, is to enable the pursuit of meritorious litigation that would otherwise be difficult or impossible to bring. If there are insufficient controls on funders, including on the ability to influence proceedings and in the amount of profit they can take, then the reasons for allowing the funded litigation in the first place disappear.

We are also concerned that litigation funders may prevent plaintiffs from settling, or discontinuing proceedings when they otherwise would have, in order to maximise their own profits. It would be exceedingly inappropriate and conflicted if the plaintiff's lawyer were put under pressure to act in the interests of the funder rather than their client.

Caution should also be exercised around allowing litigation funding agreements to advance which allow the funder to unilaterally withdraw funding, as this would provide the funder with an unreasonable level of control over the proceedings. Any ability to withdraw funding should be accompanied by an obligation to notify the defendants and should act as a stay of proceedings pending further information being provided on security for costs going forward. If a funder were to withdraw, we believe that a recertification process should take place to ensure that there is still sufficient financial protections in place for the plaintiff to meet any costs.

In the Australian PJCCFS report, the committee recommended (amongst other things):

- improvement to transparency and management of potential conflicts of interest between group members, litigation funders and legal representatives, including appointing contradictors to act on behalf of group members in the settlement process and imposing a statutory requirement that funders act in accordance with the overarching purpose of the class action legislation (recommendations 17, 18, 19, 22 and 23 to 26)
- proportionality of costs incurred in litigating a class action, considering factors such as potential return to group members, impacts on court resources, regulatory outcomes and the public interest (recommendations 1 and 20)

[13] As per section 24, part 5, of the Class Actions Bill and Rules 2009.

- increased regulation, direct court supervision (and, where warranted, court intervention) of litigation funding and contingency fee arrangements, including a presumption that litigation funders provide security for costs and complete protection for lead plaintiffs against adverse costs orders.

Q43. Are you satisfied that existing mechanisms can adequately manage the concerns about funder control of litigation?

We do not believe that existing mechanisms can adequately manage concerns about funder control of litigation, which has been evident from the outcomes of several funded actions. One of the current controlling mechanisms is the funding agreement itself, and the court has repeatedly shown reluctance to interfere with that agreement, with the recent partial exception of the liquidators in the 'Stonewood Homes'[14] case where part of the agreement was struck down.

Another available mechanism to manage funder control is a stay of proceedings. However, given the *PricewaterhouseCoopers v Walker*[15] decision, it appears uncertain when the court will act due to funder control.

Finally, we agree with the comments made in paragraph 19.18 of the Issues Paper that the jurisdiction to strike out proceedings is unlikely to assist where there are issues with the funding agreement, as the focus of this mechanism is on the cause of action.

Q44. If not, how should the concerns about funder control of litigation be managed? For example, should litigation funders be encouraged or required to include minimum terms in their litigation funding agreements? If so, what minimum terms would be appropriate?

We believe that there should be minimum terms for litigation funding agreements and agree with the suggested terms set out in paragraph 19.24 of the Issues Paper. In regard to terms setting out the funder's role in decisions about whether to settle and on what terms, we would like to see the inclusion of a term which limits the situations in which funding can be withdrawn, which may make it less likely that plaintiffs are prevented from settling based on a reasonable offer, or discontinuing proceedings simply because it may not be in the best interests of the funder.

The High Court Rules should also provide for mandatory disclosure of a litigation funding agreement, and the court should be given the power to strike down terms of the agreement if they risk creating a conflict of interest or imbalance in bargaining power between the plaintiff and funder or lawyer.

Q45. What concerns, if any, do you have about funder-plaintiff conflicts of interest?

There is potential in the funder-plaintiff relationship for conflict between the profit-driven motive of the funder and the justice-driven motive of a plaintiff. These interests may align to a point, but issues where interests do not align may arise, particularly in relation to remuneration of the funder, decision-making through the litigation, and settlement. In our view, it is the point in relation to settlement where the greatest potential for conflict lies. The most likely scenario is that the plaintiff wants to settle (possibly on terms which include non-monetary undertakings), whereas the funder does not, in order to maximise its profits. This sort of stalemate will protract proceedings and

[14] *Cain v Mettrick* [2020] NZHC 2125 (21 August 2020).
[15] *PricewaterhouseCoopers v Walker* [2017] NZSC 1151 [2018] 1 NZLR 735.

increase costs, and potentially harm plaintiffs if the funder has such control of the proceedings that they have the ability to make the decision regarding settlement.

Q46. Are you satisfied that existing mechanisms can adequately manage the concerns about funder-plaintiff conflicts of interest?

No, we do not believe that existing mechanisms satisfactorily address funder-plaintiff conflicts of interest. Courts have shown a reluctance to interfere with the funding agreement, and there is no code of conduct or regulation of litigation funder conduct to ensure good outcomes and the prioritisation of plaintiff interests, which only serves to increase the risk of a conflict of interest. At present, without regulation or court oversight, we believe that there is a high risk that inexperienced or passive plaintiffs may sign up to funding agreements that are not in their best interests and which do not properly manage conflicts of interest.

In order to manage any funder-plaintiff conflicts, it may be helpful to introduce a requirement for the court to approve all settlements. This will give an extra layer of protection in addition to improved oversight of funding agreements.

Please also see the comments previously made in question 42, in relation to the Australian PJCCFS committee recommendations.

Q47. If not, which option for managing the concerns about funder-claimant conflicts of interest do you prefer, and why? For example:

- ***a. Should funders be encouraged or required to include minimum terms in their litigation funding agreements? If so, what minimum terms would be appropriate?***
- ***b. Should funders be required to have a conflicts management policy?***
- ***c. Should funder control of litigation be regulated?***

Ideally, all three options would be used for managing funder-claimant conflicts of interest. Please see our comments in response to questions 42 regarding the appointment of contradictors to act on behalf of group members in the settlement process and proportionality of costs, and 44 above in relation to the use of mandatory minimum terms. In regard to the regulation of funder control, we note the limitations of regulation as outlined in paragraph 20.32 of the Issues Paper even when explicit conflicts appear to have been managed. For that reason, we encourage Te Aka Matua o te Ture to consider the introduction of something like a code of conduct, such as already applies to lawyers[16] financial advisers.[17] This would ensure that litigation funders similarly have a duty to act in the best interests of the plaintiff and class members rather than in the interests of their investors.

Q48. What concerns, if any, do you have about lawyer-client conflicts of interest in funded proceedings?

The obvious concern in this situation is that the lawyer is paid by the third party funder, and it is not only that the payment of their current bills depends on that funder, but they may also wish to secure future business. The desire to secure further business, or a pre-existing commercial relationship may incentivise the lawyer (whether consciously or not) to prioritise the funder's interests and preferred

[16] Rules of client and conduct care for lawyers.
[17] Code of Professional Conduct for Financial Advice Services.

course of action. We note that a similar situation can emerge in insured litigation, however insurers instructing lawyers, have an overriding duty of utmost good faith to their customers[18] (and lawyers have a similar duty), which litigation funders do not have. The majority of general insurers in Aotearoa New Zealand are also members of ICNZ and must comply with the Fair Insurance Code which sets out a number of customer-focussed obligations including acting with utmost good faith, treating customers fairly and honestly, and acting in the interest of their customers.[19]

There is also an obvious conflict if the lawyer were to also act as, or have interest in, the funding arrangements. We note that the Parliamentary Joint Committee on Corporations and Financial Services covered this issue in their report, ultimately concluding "It is clear to the committee that there should be a strict separation between the litigation funder and the representative plaintiff's lawyers in a class action. A prohibition is the best approach for ensuring uncompromised, objective and independent advice to, and advocacy of, the representative plaintiff".[20] ICNZ believes that Aotearoa New Zealand should also prohibit lawyers from having any interest in a litigation funder where they act for the plaintiff, so as to avoid any doubt.

Q49. Are you satisfied that existing mechanisms can adequately manage the concerns about lawyer-plaintiff conflicts of interest?

We are not satisfied that existing mechanisms can adequately manage potential lawyer-plaintiff conflicts when the relationship is complicated by the existence of a litigation funding arrangement. We therefore believe that specific rules need to be put in place to manage conflicts and the New Zealand Law Society Code of Conduct should be updated to address lawyers acting under litigation funding arrangements.

Q50. If not, which option for managing the concerns about lawyer-client conflicts of interest do you prefer, and why? For example:

- ***a. Should funders be encouraged or required to include minimum terms in their litigation funding agreements? If so, what minimum terms would be appropriate?***
- ***b. Should professional rules or guidelines be developed for lawyers acting in funded proceedings? If so, what rules or guidelines would be appropriate?***
- ***c. Should activities that are likely to give rise to lawyer-plaintiff conflicts of interest be prohibited? If so, which activities should be prohibited?***

In our view, the code of conduct should be updated with a section for lawyers acting in funded proceedings and should address the management of conflicts of interest. As stated in our response to question 48, we believe that the rules should expressly prohibit lawyers from investing in funders, holding office, or having other interests in (including, for example, the opportunity to receive commissions from) litigation funders.

[18] *Young v Tower Insurance Ltd* [2016] NZHC 2956.
[19] See https://www.icnz.org.nz/fair-insurance-code/about-the-code/ for more information on the Code and to access a copy.
[20] Above n 9, page 282.

Q51. What concerns, if any, do you have about funder profits?

ICNZ is concerned that there is not any transparency around whether the outcome of funded litigation is in fact fair to plaintiffs, due to lack of controls on the possible profit levels. Where funders are able to take a significant percentage of the benefit of the litigation, then the policy argument for allowing class actions as a public benefit and to increase access to justice falls away, and the court process becomes a vehicle for profit-making. Where funder profits are significant, as they often appear to be (for example, in the *PricewaterhouseCoopers v Walker* case, the funder was contractually entitled (after reimbursement of its costs) to a fee of either two times the cost or 42.5% of the net resolution sum, whichever was the greater),[21] this means that to be successful, an insured plaintiff has to obtain a result substantially better than what they may be entitled to under the insurance policy or at law. In insurers' experience, the effect of such funding arrangement has been that claims which perhaps would not otherwise have been pursued were taken to court, and expectations for settlement were raised, firstly, due to advice from the plaintiff's lawyers and funder, and secondly, simply to cover their own costs and loss.

Please also refer to our answer in question 42 above regarding the Australian PJCCFS recommendations.

Q52. Are you satisfied that existing mechanisms can adequately manage the concerns about funder profits?

We are not satisfied that existing mechanisms can adequately manage the concerns about funder profits because, as already stated, there are no reported cases in tort founded on maintenance and champerty. Based on the decision in *PricewaterhouseCoopers v Walker*, it is also uncertain as to when the court will stay proceedings due to funder control and profit.

Q53. If not, which option for managing the concerns about funder profits do you prefer, and why? For example:

- ***a. Should competition in the litigation funding market be encouraged? If so, how?***
- ***b. Should the courts be empowered to vary funder commissions? If so, when, and how?***
- ***c. Should funder commissions be regulated? If so, should there be a restriction on how funder commissions can be calculated (and if so, what) or should funder commissions be capped (and if so, how)?***

ICNZ believes that there is merit in options a. and c. set out above. Competition should be encouraged in the litigation funding market as it will help to moderate funding commission and increase service levels. Providing an exception to champerty and maintenance for litigation funders should also increase competition in this market.

In our view, it is more appropriate for litigation funders to be regulated, than for courts to have the ability to vary funder commissions, as it is unlikely that the courts will have the requisite expertise to

[21] As another example, in Australia, the litigation funder in *Endeavour River Pty Ltd v Responsible Entity Limited*, at a reduced commission level of 25%, was to receive 457% of its costs. See the Parliamentary Joint Committee on Corporation and Financial Services Litigation funding and the regulation of the class action industry report, page 117.

engage in discussions on commission.[22] That is why it would be preferable for there to be a cap on commissions. A cap would provide greater certainty for plaintiffs and appears to be a more commercially realistic option given that, presumably, funders will expect a larger return where the claim amount is higher. One possible option for setting a cap would be to benchmark it against private equity returns.

Q54. What concerns, if any, do you have about the capital adequacy of litigation funders?

From an insurance perspective, our main concerns are that funders may not have sufficient capital to pay an adverse costs order and that there is real potential for disruption to defendants if a funder collapsed. At present there is no regulation of funders' capital adequacy, which, for what is essentially a financial institution, seems inconsistent with the treatment of other such entities.

Q55. Are you satisfied that the existing security for costs mechanism can adequately manage the concerns about funders' capital adequacy?

No, we do not believe that security for costs is a satisfactory mechanism to allay concerns about capital adequacy. We believe that there needs to be greater certainty that a funder has adequate resources to pay adverse costs, particularly given that litigation funders are not party to the proceedings. In order to both protect the interests of plaintiffs and provide certainty for defendants, there needs to be greater regulation of funder capital. If there is not regulation of funder capital adequacy, the security for costs mechanism should be further strengthened (including payment of conservatively high amounts) where funders are unable to demonstrate adequate resources.

Q56. If not, should the security for costs mechanism be strengthened? In particular:

- ***a. Should there be a presumption or requirement that a litigation funder will provide security for costs in funded proceedings?***
- ***b. Should there be a requirement that security for costs is provided in a form that is enforceable in Aotearoa New Zealand?***

ICNZ supports both of the above suggestions. There should be a presumption that a litigation funder will provide security for costs. As the Australian Law Reform Commission found and is set out in paragraph 22.20 of the Issues Paper, a statutory presumption will retain the court's discretion and ensure the presumption can be rebutted in suitable cases, such as where the matter is in the public interest.

There should also be a requirement that security for costs is provided in a form that is enforceable in Aotearoa New Zealand, preferably by a payment into the court. Defendants should not be at risk of having to litigate in another jurisdiction, incurring yet further expenses, to recover the costs they are entitled to.

[22] In the Menzies Research Centre's report *Litigation Nation: How Australia has become an investment destination at the expense of justice*, June 2020, page 23, they also state that "judges do not have the experience and training in corporate finance to properly assess the risks and returns" and can become "unwitting accomplices in what is unconscionable conduct on the part of the litigation funding industry".

Q57. Alternatively, or additionally, should litigation funders operating in Aotearoa New Zealand be subject to minimum capital adequacy requirements? If so:

- ***a. Should any minimum capital requirement be formulated by specifying a particular amount (and if so, what amount) or an amount correlated to a funder's financial commitments (and if so, what correlation), or in some other way?***
- ***b. Should minimum capital adequacy requirements be able to be satisfied if the funder's capital is held in another jurisdiction, or should the capital be held in Aotearoa New Zealand?***
- ***c. What other requirements, such as audit requirements, would be appropriate?***
- ***d. Who should oversee compliance with any minimum capital adequacy requirements?***
- ***e. What consequences should follow from a funder's non-compliance with any minimum capital adequacy requirements?***

Further to the above response, ICNZ believes that litigation funders operating in Aotearoa New Zealand should be subject to minimum capital adequacy requirements, which should correlate to the funder's financial commitment to the particular proceedings. This relationship between financial commitment and capital adequacy would provide greater reassurance to both the plaintiff and defendant of the funder's ability to meet its financial commitments than a purely arbitrary figure. We also reiterate that the funder should be required to hold the capital in Aotearoa New Zealand, or to have assets appropriately 'ring-fenced' to protect the interests of Aotearoa New Zealand plaintiffs and defendants, otherwise there may be difficulties in accessing the capital. This also reinforces the benefit of the provision of a litigation plan during the certification process, as it could be used to inform the assessment of capital adequacy based on costings and reserves.

We agree that capital adequacy requirements should also include auditing requirements and continuous disclosure obligations. We therefore support the requirements set out at paragraph 22.36 of the Issues Paper, with the requirement to maintain adequate financial resources at all times to meet the obligations of the funder to fund all the disputes they have agreed to fund and maintaining the capacity to pay all debts when they become due and payable being the most pertinent from an insurer's perspective.

In ICNZ's view, there should be civil penalties for funders' non-compliance with capital adequacy requirements.

Q58. Which of the concerns with litigation funding, if any, warrant a regulatory response?

ICNZ believes that regulation of litigation funding would improve transparency of funding arrangements and ensure funders are subject to appropriate scrutiny and accountability, which is essential for a well-functioning regime which protects the interests of plaintiffs and provides certainty for defendants. Regulation would also help to improve access to justice and address a number of the concerns covered in this submission, including funder control of litigation, the potential for conflicts of interest, unreasonable funder profits, and capital adequacy for litigation funders.

Q59. Which option for the form of any regulation and oversight do you prefer, and why? For example, should regulation and oversight of litigation funding take the form of:

- ***a. Industry self-regulation and oversight?***
- ***b. Managed investment scheme requirements, overseen by the Financial Markets Authority?***
- ***c. Tailored licensing requirements overseen by the Financial Markets Authority (or another existing regulator)?***
- ***d. A tailored statutory regime, overseen by a new oversight body?***
- ***e. Court approval of litigation funding arrangements?***
- ***f. A combination of the above?***

ICNZ believes that the most effective mechanisms would be a tailored statutory regime for litigation funders, with oversight by a regulatory body together with court approval of litigation funding arrangements and settlements. In terms of funding arrangements, court approval should only go so far as considering minimum terms of funding agreements, as prescribed by regulation, which could be performed as part of the certification process for class actions, but may also be a useful mechanism in other litigation. As stated earlier in the submission, there should be regulations addressing the issue of funder fees rather than having the courts tasked with assessing suitable levels of commission, given that this would not be their area of expertise.

In addition to the above options, and to achieve consistency with other financial institutions such as banks and insurers, litigation funders should be also subject to good conduct obligations to ensure that they take a consumer-focus in their approach to funding arrangements. This should specifically include an obligation to identify vulnerable customers. In this context, the 'customer' would include the plaintiff, whose action they are funding, and those who they have sourced that funding from.

Q60. Are there any concerns about litigation funding, or options for reform, that we have not identified? Is there anything else you would like to tell us?

There are two other issues to raise in relation to litigation funding. Firstly, ICNZ disagrees with the comments made in paragraph 17.49 of the Issues Paper which states that Te Aka Matua o te Ture has not yet seen robust evidence in support of those claims. While funded class actions may not be wholly responsible for the rise in premiums, they certainly make a significant contribution to the problem.[23] Part of the issue is the current litigation environment and increase in regulator activity. Evidence shows that class actions, and securities class actions in particular, have played a large part in Australia in driving increases in D&O premiums. While Aotearoa New Zealand has not seen the same sort of class actions and litigation funder-driven proceedings, trends in our insurance market are heavily influenced by the claims experience in Australia, and ICNZ data shows a steady increase in gross written premiums for D&O insurance in Aotearoa New Zealand.[24] On the link between class actions and D&O premiums, the Australian PJCCFS confirmed in their report that "the increasing prevalence of shareholder class actions has broader undesirable outcomes on the availability and cost of D&O insurance, with consequential challenges for attracting and retaining experienced and high quality directors and officers".[25] The impact of funded class actions may be broader than just D&O insurance, with them also affecting general liability and professional indemnity costs for

[23] For a detailed discussion on the various factors affecting D&O premiums see MinterEllisonRuddWatts Litigation Forecast 2021, pp 8-11.
[24] Subject to the necessary approvals, ICNZ could provide this data to Te Aka Matua o te Ture on a confidential basis.
[25] Above n 9, page 349.

companies. It would not be socially desirable for liability insurance to become unavailable or unaffordable, particularly from the class members' perspective, as many defendants will have the backing of an insurer, and they may be left in a worse position if insurance is no longer available. More broadly, the reduction in the affordability and availability of D&O insurance may put additional pressure on the already dwindling pool of those who are prepared to be in governance roles, as is noted in paragraph 6.32 of the Issues Paper.

Secondly, further to the comment in response to question 59 above, to the extent that the litigation funder is sourcing funding from the Aotearoa New Zealand public, we would expect these offerings to be regulated as any other investment product would be (for example, in Australia, litigation funders are regulated as a Managed Investment Scheme).[26]

Conclusion

Thank you again for the opportunity to submit on the Issues Paper. If you have any questions, please contact our Legal Counsel on (04) 475 8008 or by emailing jane@icnz.org.nz.

Yours sincerely,

Tim Grafton
Chief Executive

Jane Brown
Legal Counsel

[26] https://asic.gov.au/regulatory-resources/funds-management/litigation-funding/.