Corporations and Securities Section of the Commercial Bar Association of Victoria[1]

SUBMISSION TO LEGAL SERVICES COUNSEL ON DRAFT *LEGAL PROFESSION UNIFORM GENERAL AMENDMNET (MANAGED INVESTMENTS SCHEMES) 202*1; PROPOSED AMENDMENT TO RULES 91B AND 91BA OF *LEGAL PROFESSION UNIFORM GENERAL RULES 2015*

Introduction – summary and purpose of submissions

1. These submissions respond to the invitation contained in the Legal Services Counsel's ("LSC's") letter dated 6 May 2021 to the Victorian Bar, concerning proposed amendments to Rules 91B and 91BA of the Legal Professional Uniform General Rules 2015 ("rules") concerning managed investment schemes.

2. For the following reasons, the Commercial Bar Association ("**CommBar**") submits that:

   (a) Rule 91B should not be changed from its present form; and

   (b) Rule 91BA should be allowed to lapse when it expires in August 2021.

Legal Profession Uniform Law

3. The reference arises from section 258(3) of the Legal Profession Uniform Law ("Uniform Law"), which restricts a law practice from providing legal services in relation to a managed investment scheme in which any associate of the practice has an interest. The section provides:

> *(3) Except as permitted by or under the Uniform Rules, or as approved by the designated local regulatory authority, a law practice must not provide legal services in relation to a managed investment scheme if any associate of the law practice has an interest in the scheme or the responsible entity for the scheme.*

Issue 1: Rule 91B

4. Rule 91B provides for "carve-outs" or exemptions from the restriction in section 258(3). The present version of Rule 91B provides:

> *(1) For the purposes of s 258(3) of the Uniform Law, a law practice is permitted to provide legal services in relation to a managed investment scheme, despite an associate of the law practice having an interest in the scheme or the responsible interview for the scheme, if:*
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> *(a) those legal services are provided to the operator of the scheme, or*
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> *(b) no associate of the law practice has a substantial interest (within the meaning of sub-rule (2)) in the scheme or the responsible entity for the scheme, or*
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> *(c) one or more associate to the law practice has a substantial interest (within the meaning of sub-rule (2)) in the scheme or the responsible entity for the scheme but no principal of the law practice either:*

[1] This submission is made on behalf of the Corporations and Securities Section of the Commercial Bar Association of Victoria, rather than on behalf of the Association more generally.

(i) knows of any of those interests, or

(ii) ought reasonably to know of any of those interests.

(2) For the purposes of sub-rule (1), an associate has a substantial interest in a managed investment scheme or responsible entity if the associate:

(a) is entitled at law or in equity, to an interest in the assets of the managed investment scheme or responsible entity, which is significant or of relatively substantial value, or

(b) exercises any material control over the conduct and operation of the managed investment scheme or responsible entity, or

(c) has an entitlement to a share of the income of the managed investment scheme or responsible entity, which is substantial, having regard to the total income which is derived from it.

5. The LSC says that "Rule 91B is intended to narrow that restriction [i.e. the prohibition under section 258(3)] so it prevents a law practice from acting in relation to a managed investment scheme only where it is necessary to do so in the public interest".[2]

6. It is however hard to see how that professed intention is reflected in the wording of the current Rule 91B. Rather, the current version appears intended to permit a law practice to provide legal services in relation to a managed investment scheme or its responsible entity notwithstanding section 258(3) where either (1) the services are provided to the **responsible entity** of the scheme (rather than the scheme itself), (2) any interest in the scheme held by an associate of the practice is not a "substantial interest" (as defined) or (3) the interest is unknown and ought not reasonably be known to a principal of the practice.

7. Now, it is proposed to replace Rule 91B to permit a law practice to provide legal services in relation to a managed investment scheme where an associate has an interest in the scheme or its responsible entity "*but the provision of those legal services does not give rise to a conflict between the duty to serve the best interest of the client and the interests of the associate of the law practice*". The change is said to be because of "stakeholder feedback" that the current version of rule 91B "creates an unreasonable compliance burden because it requires law practices to take proactive steps to ascertain whether any associate has a substantial interest".[3]

8. This "stakeholder feedback" appears to misunderstand the effect of the current version of Rule 91B. The exception applies unless a principal of the law practice either already knows of the associate's substantial interest in the scheme or "ought reasonably to know" of it. There is nothing in those requirements that mandates the taking of proactive steps. The requirement is not to act with actual knowledge or unreasonable or wilful blindness.

9. It would not in any event be unreasonable to require a law practice to take proactive steps to ascertain whether any associates of the practice might have a substantial interest in a

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2 LSC discussion paper, May 2021, p 3.

3 LSC Consultation Paper, May 2021, p 4.

managed investment scheme for which the law practice proposes to provide legal services, in circumstances where not to do so might create a conflict between the law practice's fiduciary duty to its clients and its self-interest.

10. As the discussion paper recognises, law practices are required to undertake "normal conflict checking procedures" before acting for a client. These typically include ascertaining whether principals and associates of the practice have an interest in the proposed client or its opponent and whether another client of the practice has interests that might be affected adversely (e.g., another party to litigation or on the other side of a transaction). Otherwise, the practice risks contravening its existing duties not to act for a client in a matter in which it has a personal interest,[4] where the interests of the different clients might conflict,[5] where confidential information held on behalf of a client might be misused,[6],or where it would breach the law practice's 'duty of loyalty' to the existing client.[7] It is not unreasonable to expect a law practice to undertake a similar "conflict check" when providing legal services to or in relation to a managed investment scheme. Indeed, the discussion paper contemplates that normal conflict checking procedures would "suffice to unearth any conflicts that would trigger the operation of s 258(3)".

11. Further, the proposed change to rule 91B will not make much difference to the substantive law. It is difficult to see how, where an associate of a law practice has a "substantial interest" in a managed investment scheme or responsible entity (as the current version of sub-rule 91B(2) provides), the provision of legal services by the practice would not give rise to a conflict between duty and interest as contemplated by the proposed replacement provision. That is because, as the High Court explained in *Ebner v Official Trustee in Bankruptcy*[8] in the context of whether a Judge should be recuse him or herself from hearing a case by reason of having a pecuniary interest in a litigant in the form of a shareholding in a company, the Judge need not recuse him or herself where the interest is slight, insubstantial or indirect but should do so if the interest were substantial in the sense that the outcome of the litigation might affect the share price.

12. Of course there are significant differences between the situation of a solicitor or barrister as a fiduciary and a Judge having a reasonable apprehension of bias. Nevertheless, where an interest were 'substantial', it would have to be that there was necessarily a conflict of interest (or at least a potential conflict of interest) in the law practice acting for a managed investment scheme, for the same reason that there would be for a judge determining litigation. That is

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4 *Clark Boyce v Mouat* [1994] 1 AC 428, at 437 (PC).
5 e.g., *Target Holdings Ltd v Redferns (a firm)* [1996] AC 421.
6 *Bolkiah v KPMG* [1999] 2 AC 222, at 234; *Beach Petroleum v Kennedy* (1999) 48 NSWLR 1, [204] (CA).
7 *Spincode v Look Software* (2001) 4 VR 501, at [56], [60]; *Longstaff v Birtles* [2002] 1 WLR 470.
8 (2000) 205 CLR 337, at [37], [55] (per Gleeson, McHugh, Gummow and Hayne JJ).

because the associate of the law practice with the substantial interest would stand to gain or lose from the conduct and success or failure of the managed investment scheme.

13. This issue is particularly likely to arise in class actions. That is because of decisions to the effect that a class action with more than 20 class members falls within the definition of a "managed investment scheme" in section 9 of the *Corporations Act* 2001.[9]

14. Where an associate of a law practice has a 'substantial' interest in the class action (other than the right to receive legal fees for providing legal services in relation to the class action), there would – on the basis of the authorities referred to above[10] – also be either an actual or potential conflict of interest within the meaning of the amended rule 91B in any event.

15. It may be that "the best interests of our client" [i.e. the managed investment scheme, the responsible entity or the members of the relevant class] and "the interests of the associate of the law practice" would be aligned where the associate was actually a member of the class. All would want the action or other relevant activity to succeed. Nevertheless, there are many situations where there either will or might be a conflict between duty and interest. The potential conflict is particularly likely to arise where the right or likelihood of the law practice or the associate to recover fees depends upon whether the class action is settled and on what terms. It is not difficult to envisage circumstances where a settlement may be more advantageous to the law practice or the associate than the class members, particularly insofar as legal costs or their recovery is concerned. Thus, a conflict may arise. The law practice may have to weigh, for instance, whether a settlement is more likely to bring more benefit to the members of the class than continuing with the action and possibly winning – or losing – it. In such circumstances, the interest of the law practice in recovering legal costs may well diverge from those of the class members.

16. It has been said that "solicitors who deal with their clients must take care not only that the transaction is fair, but that they are in a position to prove that it was fair".[11] In class actions that proof must be provided to the Court before the settlement can even take effect see for example the Federal Court of Australia Act s 33V, 33ZZF etc. There have been several recent cases where the interests of lawyers and their clients in class action settlements have diverged and conflicted in an unacceptable way: see e.g. the recent Banksia class action[12]. The LSC, in making rules under the Uniform Law, should be astute to prevent such conflicts arising. The proposed new version of rule 91B does not appear likely to assist in avoiding such conflicts.

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9 *Brookfield Multiplex Ltd v International Litigation Funding Partners Pte Ltd* [2009] FCAFC 147.

10 See also Walmsley et al, *Professional Liability in Australia* (LBC, Sydney, 2nd ed. 2007), at [3.310]-[3.390] and the cases there cited.

11 Heydon and Leeming, *Jacobs Law of Trusts in Australia*, Lexis Nexis Butterworths Sydney 8th edition 2016 at [17-46].

12 See *Bolitho v Banksia Securities Ltd (No 16)* [2021] VSC 9; see also *(No 6)* [2019] VSC 653; *(No 8)* [2020] VSC 174; *(No 10)* [2020] VSC 524; *Botsman v Bolitho* (2018) 57 VR 68 (CA); [2018] VSCA 278.

17. Further, the proposed new rule is vague. As the discussion paper makes clear, "unlike the existing Rule 91B, the proposed Rule 91B leaves it up to the law practice to decide when A's interest gives rise to a conflict. The proposed new rule will leave it up to the law practice to design appropriate compliance arrangements to ensure it can satisfy section 258(3) of the *Uniform Law*, which is a civil penalty provision."[13]

18. The problem in practice will that it will be very difficult for law practices to know in advance whether the exemption in the proposed new Rule 91B has been satisfied. It is also hard to see how they could sensibly "design appropriate compliance arrangements", given that every case will be different. It will surely be easier to check whether a principal of the law practice is aware or should be aware of a substantial interest in the managed investment scheme held by an associate of the law practice.

19. For these reasons, the existing Rule 91B is clearer and more certain in its application and should be retained.

Issue 2: Rule 91BA

20. It is proposed to continue the operation of the new rule 91BA, subrule (2), which is in the following terms:

> *(2) For the purposes of section 258(3) of the Uniform Law, a law practice is permitted to provide legal services in relation to a managed investment scheme, despite an associate of the law practice having an interest in the scheme or the responsible entity for the scheme, if the scheme is a litigation funding scheme.*

21. The subrule was made on 30 July 2020 to resolve what was said to be "a serious and unintended consequence of Commonwealth reforms to regulate litigation funding schemes", which arose when the exclusion of litigation funding schemes from the definition of "managed investment scheme" in the Corporations Act 2001[14] was removed.

22. Rule 91BA permits law practices to provide legal services in relation to a managed investment scheme (such as a class action) despite an associate of a law practice having an interest in the scheme or the responsible entity if the scheme is a litigation funding scheme following the removal of this exemption. The exemption in the current rule is a blanket one. The existing rule 91BA expires on 22 August 2021.

23. In the view of the Corporations and Securities Section, it would be better to allow rule 91BA to expire. It is undesirable for law practices providing legal services to managed investment schemes in the form of litigation funding of class actions where an associate of the law practice also has a substantial interest in the scheme or the responsible entity.

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13 LSC discussion paper, May 2021, p 5.

14 See definition of "managed investment scheme" in section 9 and Reg 5C.11.01.(1)(b)-(d). The reforms were made in response to the decision in *Brookfield Multiplex Ltd v International Litigation Funding Partners Pte Ltd* [2009] FCAFC 147: see generally See LSC discussion paper (May 2021), p 6

24. Again, there is an obvious conflict of interest in conducting and settling the litigation particularly where a settlement might provide certainty of payment of legal costs and disbursements to the funder but not necessarily the best return to the members of the class. It could contravene the law practice's general law duties (of fidelity, avoidance of conflict of interest, confidentiality and loyalty etc) for it to be in a position where its duty to the members of the scheme who are its clients were to conflict with its interest as a litigation funder. As set out above, that might occur where a settlement offer was made that, if accepted, would ensure that the litigation funder and the law practice could recover substantial legal costs, but may not necessarily represent the best result for the managed investment scheme or class members[15].

25. It would be preferable for the litigation funder entity to be completely separate from the law practice advising and acting for the class, so that objective advice can be provided. The funder could continue to protect its interests by having appropriate contractual arrangements (for example, the right to insist on independent advice about the appropriateness of any proposed settlement from senior counsel practicing in the relevant area in the event of disagreement about whether a particular settlement proposal should be agreed to).

Conclusion

26. The authors would be pleased to discuss these matters with the LSC further and in greater detail if required.

Corporations and Securities Section,
Commercial Bar Association of Victoria

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15 e.g., *Bolitho v Banksia Securities Ltd (No 16)* [2021] VSC 9; see also *(No 6)* [2019] VSC 653; *(No 8)* [2020] VSC 174; *(No 10)* [2020] VSC 524; *Botsman v Bolitho* (2018) 57 VR 68 (CA); [2018] VSCA 278.