AALF

Association of Litigation Funders of Australia

Submission to the Senate Economics Legislation Committee

Inquiry into the Corporations Amendment (Improving Outcomes for Litigation Funding Participants) Bill 2021

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Introduction

1 The Association of Litigation Funders of Australia (**AALF**) welcomes the opportunity to make this submission to the Committee's inquiry into the *Corporations Amendment (Improving Outcomes for Litigation Funding Participants) Bill 2021* (**Bill**).

2 I am the Chief Executive Officer and founder of ICP, Managing Director of ICP Capital Pty Ltd, ICP Funding Pty Ltd and the Chair and co-founder of the Association of Litigation Funders of Australia.

3 In 1996, I founded Insolvency Management Fund Pty Ltd to fund insolvency claims around Australia. In 2001, I co-founded and was an inaugural director of IMF (Australia) Ltd (now Omni Bridgeway Ltd) and remained a director until 2015 (being the Managing Director between 2004 and 2008). In 2016, I founded ICP and in 2017, 2018 and 2020, I founded ICP Capital, ICP Funding and CASL Governance Ltd, respectively, to predominantly fund class actions.

4 The principle economic issues raised by the Corporations Amendment (Improving Outcomes for Litigation Funding Participants) Bill 2021 (**the Bill**) arise from:

(a) the rebuttable presumption that no more than 30% of claim proceeds can be available to fund the expenses of the class action litigation funding scheme (the **30% Cap**);

(b) the uncertainty created by the Bill, particularly in respect of its intended commercial effect upon open classes and the consequential diminution in competition;

(c) market misbehaviour due to less market protection law enforcement; and

(d) the inequality in arms available to plaintiffs and defendants in our adversarial civil justice system.

Open Classes, CFOs and Competition

5 First, it is important to understand how class actions have been made economically viable in the past 20 years before we can understand the Bill's potential economic consequences.

6 Until third party funding became available for class actions about 20 years ago, class actions were limited primarily to being funded by a couple of law firms on a "no win, no fee" basis. Neither of these firms had the financial capacity to conduct large claims without risking insolvency (refer to the Ok-Tedi and GIO claims run by Slater and Gordon and Maurice Blackburn, respectively). Defendants were also unable to be paid their costs in

the event of the failure of the claim due to human plaintiffs not having to provide security for costs.

7 Successful recovery of damages for class members was limited until the introduction of third-party funding commenced with the listing of Omni on the ASX in 2001. Omni was the first litigation funder globally to raise capital to invest in class actions.

8 Until the *Money Max* decision in 2016, funding was exclusively limited to class actions for class members who had entered into a funding agreement with the funder (**Closed Classes**).

9 Whilst this made funding commercially valuable by restricting "free riders", it did not reflect the intention of the class action regime in the *Federal Court of Australia Act* 1976 to have class actions include all potential claimants and thereby:

(a) increase access to justice; and

(b) provide an efficient mechanism to deal with all claims and create finality, particularly for the defendant.

(**Open Classes**)

10 Capital invested in class actions steadily increased during the Closed Class period.

11 The funding model continued to be on the basis that the funder would underwrite the plaintiff's costs of litigating and pay the defendant's costs if the claim failed and in return would receive its capital back as a priority only from claim proceeds, if any, together with an agreed percentage of the claim proceeds by way of return on investment only if the claim was successful (**the Closed Class Model**).

12 The Closed Class Model enabled risk-free access to justice for clients of the funder but provided no access to justice for unfunded claims.

13 In 2016, the Full Court of the Federal Court in the *Money Max* decision introduced the availability of common fund orders (**CFOs**) for Open Classes whereby the Court granted the funder a right to share in the fund it had helped to create by reference to return of its capital and a percentage of all claim proceeds, not just by reference to its funded client's share (**the CFO Model**).

14 This decision ushered in the opportunity for greater competition in the Australian market as the Closed Class Model was largely only being utilised by funders that had a capacity to "bookbuild" (being ICP, ILP, and Omni).

15 Since the CFO Model has been available, other funders such as Augusta, Balance, Burford, Harbour, Therium, Vannin and Woodsford have entered the market.

16 As a direct result of this increased competition, funders' fees have decreased by between 20% and 40%, from greater than 30% of claim proceeds to between 20% and 25%.

17 The CFO Model, in addition to enhancing price competition, has also facilitated claims becoming commercially viable that were not viable under the Closed Class Model, thus providing greater access to justice.

18 In particular, the CFO Model enables Open Class claims to be filed where sufficient book building to justify filing is not possible due to the small size of individual claims, and/or the time and cost involved in promoting the claim. As a result of the CFO Model's availability, consumer, employment, environmental and other high volume, low individual claim value class actions are now able to be filed.[1]

19 The final relevant background to the Bill to appreciate before I address its likely economic consequences is identified in the indicative Pre-Bill Claim Distribution Model. This model is provided merely for indicative purposes and does not include funders' overheads. Its elements ought to be the subject of thorough research and analysis before there is the necessary evidentiary basis for the passage of this Bill.

Pre-Bill Claim Distribution Model

20 The Pre-Bill Claim Distribution Model is merely indicative and used to highlight the following:

(a) legal costs and disbursements paid to lawyers (being about 70% of legal costs and 100% of disbursements):

(i) diminish as a percentage of claim proceeds as claim proceeds increase; and

(ii) are paid in priority to funders and claimants;

(b) all claim proceeds are likely to go to pay legal costs and disbursements and scheme costs and adverse cost order insurance until claim proceeds exceed these costs;

(c) whilst legal costs and funding fees are inversely proportionate to claim proceeds, Claimant's returns are proportionate; and

[1] This benefit is not available through Fee Equalisation Orders as they merely spread the cost of funding to clients of the funder across all claimants, thereby not having the capacity to enable claims that otherwise need sufficient bookbuild to be commercially viable.

(d) legal costs and disbursements and funder's net fees average approximately 12% and 20% of claim proceeds, respectively.

21 The Pre-Bill Claim Distribution Model does not, however, address the cost of unsuccessful class actions where funders, as distinct from lawyers and claimants, bear the total loss. A sample of loss-making funded class actions, together with other unsuccessful class actions, illustrates why funders' average percentage returns are likely to be well below 20% of claim proceeds. The downside risks borne by funders are significant and are typically not included in any debate or analysis of funders' returns.

Post-Bill Claim Distribution Model

22 The economic consequences for funders associated with the passage of the Bill are best analysed first by reference to a Post-Bill Distribution Model Assuming all Claims Proceed.

23 The presumption that it will not be fair and reasonable if non-claimants receive more than 30% of the claim proceeds:

(a) makes no difference where the claims are unsuccessful, with the funder paying the lawyer's costs and disbursements and the scheme and insurance costs, with claimants receiving nothing;

(b) at the lower levels of claim proceeds (to about $15m), there would be a transfer from the funder to the claimants of all proceeds to be received by the funder;

(c) at lower to medium levels of Claims Proceeds (to about $45m), there would be a material but diminishing transfer from the funder to the claimants of proceeds to be received by the funder;

(d) where claim proceeds are between $50m and $90m, there is a less material and diminishing transfer from the funder to the claimants of proceeds to be received by the funder; and

(e) for claim proceeds $100m and over, the Bill is likely to have no economic effect.

Post-Bill Claim Distribution Model Assuming Funders are Economically Rational

24 Funders' preparedness to be paid a percentage of a recovery when the claim proceeds are not known at the time of investment is one risk that needs to be taken into consideration. The risk of total failure of the claim is merely one end of this spectrum of risk.

25 Where the risk of claim proceeds being less than $50m is too high, funders are likely to see a return of less than 16% of the lower end claim proceeds as being too small to justify

the investment risk leading to a material number of meritorious claims not receiving funding and therefore not being filed. It is important to understand that when funders make investment decisions, they assess commercial viability by reference to possible/probable claim proceeds, being discounted by reference to potential claim values. As a result, there is a significant possibility that class actions with claim values greater than $50m will not proceed due to the certainty as to claim proceeds being insufficient when the decision to fund them are made. The **Post-Bill Claim Distribution Model Assuming Funders are Economically Rational** indicates the economic effect of the Bill upon the lower end of the claim proceeds spectrum.

26 A simple model to Estimate Claim Proceeds Not Collected illustrates that about $290m annually in claim proceeds over 16 class actions will not be collected; representing about 28% of all annual proceeds.

27 This results from:

(a) the Bill seeking to set aside at least 70% of recoveries for claimants; and

(b) funders only receiving return of their capital, but no return on that capital (i.e., commission), after legal costs and disbursements and scheme and insurance costs are accounted for.

The Bill Discourages Open Class Actions and CFOs

28 In addition to the quantitative consequence of smaller claims not proceeding due to the 30% presumption, there will also be a material qualitative consequence as to the types of class actions that will be able to be funded due to *"a key intention of the Bill that only those plaintiffs who have consented to become members of the class action litigation funding scheme are liable to contribute to the litigation funder's fee or commission"* (paragraph 1.23 of the Explanatory Memorandum).

29 In the two business days granted by the Parliamentary Joint Committee on Corporations and Financial Services on 12 November 2021, AALF provided a Non-Exhaustive Sample of Class Actions that would not have proceeded on a Closed Class Basis which evidences a sample of the types of claims that are enabled only by CFOs in open classes.

30 Given the Bill places emphasis on returning to the Closed Class Model, many class actions that cannot be the subject of commercially viable book builds such as consumer cases, will simply not be funded or filed.

31 In addition, should a return to the Closed Class Model emerge following passage of the Bill, this will diminish the certainty provided by the Open Class Model, as closed class

actions do not provide finality to defendants. A rise in multiple closed class claims will also decrease the efficiencies provided by the Open Class Model, negatively impacting Court resources.

The Bill's Enactment Will Diminish Market Efficiencies

32 Whilst the Bill will in a micro-sense diminish the number of class actions filed due to the 30% cap and uncertainties concerning Open Classes and the availability of CFOs, the largest unintended consequence is likely to be from a macro perspective, being the diminution in the rule of law's effect upon market misbehaviour.

33 By way of example, the Australian Securities and Investments Commission's submission to the Australian Law Reform Commission's Inquiry into Class Action Proceedings and Third-Party Litigation Funders stated:

> *"The continuous disclosure obligations are critical to protecting shareholders, promoting market integrity and maintaining the good reputation of Australia's financial markets ($1.8 trillion market capitalisation with an average turnover of $5.9 billion a day).* ***The economic significance of fair and efficient capital markets dwarfs any exposure to class action damages."*** (Emphasis added)

34 ASX-listed companies number over 2,000 and yet there have been only about 57 shareholder class actions filed and completed since 1999, averaging about 2.5 shareholder class actions per year or about two-tenths of one percent in number.

35 The legal fees and expenses and funder's fees for these 57 cases would be about 40% of the $2.25bn recovered in compensation, being about $0.9bn, which is dwarfed by the drop in market capitalisation of the 57 companies in question of over $40bn upon disclosures to correct the ill-informed market in the shares of these 57 companies.

36 If filings are decreased by the Bill, and therefore less enforcement of the laws protecting our markets and their participants, including consumers, then one ought to expect less deterrence of misbehaviour and greater damage to our markets and to those Australians dependant on enforceable laws in those markets.

Justice in Adversarial Systems Requires Equality of Arms

37 Finally, our expensive adversarial civil justice system has been described as a "Rolls Royce" system that comes at a "Rolls Royce" price. Given this fact, claimants require equality of arms to access justice.

38 The Bill through legislative intervention would place a practical cap upon claimant's funding whilst well-resourced defendants would have no cap on their defence costs.

39 Insurers who fund the litigation costs of defendants and who provide indemnities in respect of adverse costs are in essence litigation funders:

(a) whose premiums dwarf litigation funders' fees; and by design

(b) have been expressly excluded from regulation under the Bill.

Conclusion

40 The Bill will not improve outcomes for prospective funded claimants in class actions and will certainly not assist in facilitating fair and efficient capital markets, consumer protection, worker protection and other interactions requiring the rule of law to moderate misbehaviour by corporations, governments and other well-resourced organisations and individuals. In fact, if enacted into legislation, the Bill will have the opposite effect of denying consumers, workers, shareholders and citizens access to justice and compensation that was available to them prior to the introduction of the Bill.

Yours sincerely

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Association of Litigation Funders of Australia