AALF

Association of Litigation Funders of Australia

Response to the Samuel Griffith Society and Menzies Research Centre on the subject of class action reform

25 November 2024

1. Executive Summary

Since inception, Australia's class action regime has returned at least $7.942 billion to the pockets of class members who have suffered loss, including at the hands of some of the world's largest corporations.[1]

A substantial portion of this recovery is facilitated by litigation funders, many of whom are members of the Association of Litigation Funders of Australia (**AALF**). Class actions are vastly expensive, with plaintiff costs routinely running to the high single and double-digit millions. AALF strongly believes in, and facilitates, providing access to justice for Australians who would otherwise have limited recourse for harms committed against them without finance to level the playing field.

Defendants and their insurers don't like litigation funding. They are usually rich enough not to need it. Whereas the people who sue them do need it (and use it). So, that the Samuel Griffith Society (**SGS**) and the Menzies Research Centre (two "think-tanks" heavily aligned with conservative politics) published papers which wish to water-down Australia's class action regime come as no surprise. The changes they contend for will *benefit* the corporations who commit the wrongs and (further) *harm* class members who suffer the loss. No fair-minded Australian would agree with their urgings – they simply do not pass the pub test.

The purpose of this paper is to set out AALF's response to the recent papers released by the SGS and the Menzies Research Centre. In addition, AALF also suggest the type of changes to the class action system which should be considered if there is a serious interest in creating a more level playing field for victims of corporate wrongdoing. In summary, AALF makes the following points:

Point 1 – The proposal by SGS to abolish Victoria's statutory Group Costs Order (**GCO**) regime is unsound. It will limit access to justice for cases where litigation funding is not available. In particular, claims where individual losses are small, but many consumers are harmed, may not be brought if GCOs are unavailable (for example, the case of "flex commissions" where dodgy car-yard finance practices resulted in ANZ Bank paying $85m to group members). Further, the actual evidence (as opposed to speculation) demonstrates that the GCO regime is achieving its object, being access to justice.

Point 2 – Litigation funders should continue to be regulated by ASIC, the ACCC and the Court. Contrary to suggestions from the SGS and the Menzies Research Centre, all Australian jurisdictions require disclosure of litigation funding agreements at the outset of class action matters. Requiring litigation funders to hold an Australian Financial Services Licence (**AFSL**) and regulating class actions as "Managed Investment Schemes" (**MIS**) will curtail the amount of third party funding available to support meritorious disputes and allow corporate interests to tie claimants up in protracted and costly procedural disputes. The view that class actions constitute an MIS has already been rejected by the Full Court of the Federal Court, with one judge rightly noting that it: *"is a case of placing a square peg into a round hole"*.[2]

Point 3 – Returns to class members (whether as a percentage of the overall "settlement" or a dollar amount) are constrained by the amount a corporation has available to pay claims, including insurance. If a corporation does not have funds to pay the full value of the claim, then the settlement (as a percentage of the overall costs) is likely to be far lower than it should be. The

[1] V Morabito, "Empirical Perspectives on Twenty-One Years of Funded Class Actions in Australia", April 2023, p. 23.

[2] *LCM Funding Pty Ltd v Stanwell Corporation Limited* [2022] FCAFC 103 at [7].

solution to this is mandatory insurance disclosure at an early stage of the proceedings to prevent insurers using unfair tactical manoeuvring to stymie just claims. Such a requirement would serve to level the current playing field, where claimants and funders are usually required to post security to cover the defendants costs should the claim fail.

Point 4 – The Menzies Research Centre accepts that the class action regime *"significantly reduces costs and improves access to justice".*[3] That is correct. It then rails against what it perceives to be *"law firms chipping away at class member's rights"*. The solution to this unfounded fear is simple: in appropriate cases, the legal costs of class members as well as the cost of litigation funding should be passed on to those who *commit* the wrong, not those who *suffer* the harm. An example where this outcome could be appropriate may be where a plaintiff succeeds at trial, but faces countless further appeals and delaying by defendants who seek to avoid meeting their just debts. These defendants, if unsuccessful, would be ordered by the Court to pay the plaintiff's legal costs and litigation funding charges. No fair-minded Australian would argue with this outcome.

Point 5 – Australia should follow the United Kingdom by introducing rules requiring parties to large scale litigation to seek approval as to the recoverable portion of their case budgets. This would remove the incentive for well-resourced defendants to use their superior resources to stymie and delay the resolution of the proceedings. Further, high post-judgment interest rates should be introduced to incentivise prompt payment of awards following judgment and, by extension, disincentivise spurious and lengthy appeals.

2. Introduction

Litigation funding improves access to justice by allowing for the prosecution of genuine claims by plaintiffs who would otherwise lack the resources to proceed with a claim.[4] This includes the all too common scenario of large-scale harm resulting in losses of a few-thousand dollars to thousands, if not hundreds of thousands, of ordinary Australians. Why should these people lose their day in court just because their dollar loss is small? Class actions go a long way to solving this problem. This essential feature, *"access to justice"*, is accepted by the Menzies Research Centre.[5] In the 22 years of the class action regime operating in Australia access to justice has been substantially facilitated, with considerable support from AALF members. So much is evidenced by the historical sum of **$7,942,885,422** paid by class action defendants to date.[6]

SGS and the Menzies Research Centre cite fears of fostering a litigious culture in Australia as a reason to row-back reform.[7] The view of the *Australian Law Reform Commission* is that, in large measure, these fears have not materialised. Instead, *"the regime has provided a remedy where, although many people are affected and the total amount at issue is significant, each person's claim is small"*.[8]

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[3] Menzies Research Centre, "Open Lawfare: How Australia became the lawfare capital of the world", July 2024, page 29.
[4] Productivity Commission 2014, "Access to Justice Arrangements (inquiry report No. 72, Vol 2)" at 607.
[5] Menzies Research Centre, "Open Lawfare: How Australia became the lawfare capital of the world", July 2024, page 29.
[6] V Morabito, "Empirical Perspectives on Twenty-One Years of Funded Class Actions in Australia", April 2023, p. 23.
[7] Samuel Griffith Society, "The case for class action and litigation funding reform", p 21; Menzies Research Centre, "Open Lawfare: How Australia became the lawfare capital of the world", July 2024, p. 20.
[8] ALRC Report 134, "Integrity, fairness and efficiency – an inquiry into class action proceedings and third-party litigation funders", December 2018, [2.6], p. 48.

In any settlement or award of damages (after trial) there are legal costs. In the context of class actions supported by litigation funders there are also funding costs, in addition to legal costs. The legal costs and funding costs are deducted from any settlement, leaving a net sum to group members. These costs cannot be deducted without approval from the court in which the action was filed.[9] The court will not approve a settlement, including legal and funding costs, if it does not consider it to be fair and reasonable in all the circumstances. This is a high hurdle to clear.

As to those costs, the empirical and objective research which is not referred to by either SGS or the Menzies Research Centre, reveals a trend in judicially approved funding commission rates. Professor Vince Morabito's research shows a decrease from 23.9% to 21.1% for the period post-2016.[10] Put bluntly: group members are doing better from class actions, not worse.

This decrease in judicially approved funding rates follows a period in the Australian class action system after the introduction of a form of statutory *"cost-sharing"* initiatives.

In 2016, the Full Court of the Federal Court of Australia held that a *"Common Fund Order"* (**CFO**) could be made which would have the effect of enabling a litigation funder to collect funding costs from *all* class members (i.e. not just from class members who had signed a litigation funding agreement).[11] The benefit of these orders is plain: firstly, it "shares the load" of the funding cost across the *entire* class and therefore does not disproportionately burden those class members who have signed a funding agreement. Secondly, CFOs also lower the expense of litigation, as costly book building is avoided which has the benefit of increasing settlement funds available for group members. Thirdly, as with GCOs, CFOs makes it economic for claims involving high numbers of small individual losses to be brought.

In July 2020, the Victorian parliament enacted legislation permitting *"Group Costs Orders"* to be sought. These are, in effect, a *"statutory common fund order for the benefit of the law practice"*.[12] The purpose of GCOs is to enhance access to justice by reducing costs and other potential barriers to commencing class actions in the Supreme Court of Victoria.[13] These are otherwise known as "contingency fees" in other jurisdictions.

Following the introduction of GCOs, in 2021, the Federal Morrison government introduced an amendment to the *Corporations Act 2001* (Cth) which established that class action proceedings were "*a new kind of managed investment scheme"*.[14] This required litigation funders to obtain and hold an AFSL and register Product Disclosure Statements for class actions (amongst other things). Unsurprisingly, these requirements resulted in significant costs and barriers to bringing just claims.

These amendments were widely criticised and subsequently repealed in 2022 after the Full Court of the Federal Court of Australia determined that the idea that class actions were managed investments schemes was *"plainly wrong"*.[15] Justice Lee stated that: *"the characterisation of litigation funding*

[9] See, for example, s 33V of the *Federal Court of Australia Act* 1976 (Cth).
[10] V Morabito, "Empirical Perspectives on Twenty-One Years of Funded Class Actions in Australia", April 2023, p. 29.
[11] *Money Max Int Pty Ltd (Trustee) v QBE Insurance Group Limited* [2016] FCAFC 148.
[12] *Maglio v Hino Motor Sales Australia Pty Ltd* [2023] VSC 757, [97] per Osborne J; *Lay v Nuix Ltd* [2022] VSC 479 at [70] per Nichols J.
[13] *Allen v G8 Education Ltd* [2022] VSC 32, [23]; *Bogan v The Estate of Peter John Smedley (Deceased)* [2022] VSC 201, [84] per Dixon J.
[14] Explanatory Memorandum to the *Corporations Amendment (Improving Outcomes for Litigation Funding Participants) Bill* 2021 (Cth), p. 3.
[15] *LCM Funding Pty Ltd v Stanwell Corporation Limited* [2022] FCAFC 103 at [96].

arrangements as managed investment schemes is a case of placing a square peg into a round hole".[16] Having class actions characterised as managed investment schemes, only increased the costs of such litigation for group members. However, the SGS and Menzie Research Centre ignore the Court decisions (and related reasoning) and seek to relitigate the issue. Enough is enough.

Recently, in two decisions, the New South Wales Supreme Court and, on appeal, the New South Wales Court of Appeal have held that litigation funding costs (the % funding costs paid by class members) are not recoverable in addition to any award of damages.[17] As the law currently stands, class members are left to suffer the impost of litigation funding rates in circumstances where defendants have agreed to, or are ordered to, pay them compensation. In AALF's view, that is a highly jarring proposition given that it leaves the unavoidable costs of obtaining justice imposed on those who have suffered loss, via a deduction from the compensation they are lawfully owed.

The points raised by SGS and the Menzies Research Centre are considered below.

3. GCO – No case for repeal

SGS calls for the repeal of GCOs, referring to media reporting from The Australian newspaper calling GCO's a *"veritable nirvana for plaintiff's lawyers"*. What should guide the debate when considering legislative reform is the empirical and objective evidence assessing GCOs against the object of promoting access to justice, rather than the opinion of journalists.

When regard is had to that evidence it is clear that, although in its infancy, the GCO regime is providing another alternative access to funding for class members outside the traditional CFO regime involving litigation funders. In fact, the empirical research states that the median GCO rate that is awarded is **24.5%**. Unless subsequently altered by the court, this will see class members receive **75.5%** of the monetary compensation in question.[18]

A GCO is an "all-in" rate, representing the only deduction made from the global settlement or damages award to class members for lawyer fees. Unlike a traditional CFO, there is no deduction for legal costs *and* a funder's cost. Under the GCO regime the law-firm takes on the risk of adverse costs, security for costs and disbursements and receives a single percentage return in consideration for providing funding.

The GCO regime is in its infancy. As a result, there are few decided cases which have considered the operation and scope of the legislation. On 28 August 2024 Justice Watson of the Victorian Supreme Court approved the first settlement of a GCO funded case in the *G8 Education Class Action*.[19] That decision approved a settlement sum of **$46.5** million which included a GCO of **27.5%** (being a payment to the law firm of **$12,787,500**). That left a net amount of **$33,712,500** to class members. This represents a net payment of **72.5%** of the settlement sum to class members.

The court approved that sum and held that it was "*comfortably satisfied*" that the GCO did not require amendment.[20] In doing so, the court considered a number of factors and weighed the evidence for itself including the: resources devoted by the lawyers, effort expended to the proceeding, certainty

[16] *LCM Funding Pty Ltd v Stanwell Corporation Limited* [2022] FCAFC 103 at [7].
[17] *Hunt Leather v Transport for NSW* [2023] NSWSC 840 and on appeal *Transport for NSW v Hunt Leather Pty Ltd; Hunt Leather Pty Ltd v Transport for NSW* [2024] NSWCA 227 at [193] – [210].
[18] V Morabito, "Group costs orders and funding commissions", January 2024, p. 19.
[19] *Allen & Anor v G8 Education Ltd (No 4)* [2024] VSC 487.
[20] *Allen & Anor v G8 Education Ltd (No 4)* [2024] VSC 487 at [113].

and transparency to class members, and that *"a GCO at 27.5% was likely to produce a greater return to group members than the combination of litigation funding and the payment of legal fees"*. This was held by the Court to be a *"very strong factor"*.[21]

The empirical evidence to date suggests that the most common GCO rate is 24.5% and the median GCO rate for class actions supported by litigation funders is also 24.5%.[22] This is important because the Menzies Research Centre proposes that litigation funding rates or lawyers' fees should be **capped** at 30% (i.e. above median rates currently being achieved).[23] Whilst "capped-pricing" has a superficial appeal there are several problems with this proposal:

First, it creates a dynamic whereby the defendants know that if they cause the plaintiff enough cost and delay, by reason of the capped pricing, there may come a time where the fee to be recovered does not exceed the plaintiff's incurred costs, making it very difficult for the plaintiff to continue to weather the burden of further expense associated with the case. AALF suspect that this is the key reason why the SGS and Menzies Research Centre are pushing for this change.

Secondly, as a matter of basic economic theory, capped-pricing pumps the brakes on competitive market forces. A better way to reduce funding rates is to encourage competition in the funding of class actions, driving rates down for the benefit of class members. Since the decision of the Federal Court of Australia in Money Max (which permitted CFOs), litigation funding rates have been on the **decline**, well below the 30% cap proposed.[24]

Thirdly, capped-pricing would render a number of smaller cases economically unviable to fund. Cases which require a greater funding commitment relative to the total potential damages sum will not get off the ground if they are not economically viable to fund. That will leave affected class members with no redress.

Fourthly, rather than an arbitrary price-cap, experienced, independent judges should continue to have the final say (taking into account all of the evidence) of what is a fair and reasonable funding rate in all the circumstances. Pursuant to legislation at the Commonwealth and State level a proceeding may not be settled or discontinued without the approval of the Court.[25] The touchstone for approval is whether the settlement is fair and reasonable in all the circumstances. The independent judiciary should continue to determine what is a fair rate of return for litigation funders, not by reference to any arbitrary price-cap.

4. No MIS – the "square peg in the round hole"

The paper from SGS proposes, as a *"key recommendation",* that class actions in Australia which are supported by litigation funders be characterised as *"managed investment schemes"* and that litigation funders be required to hold an AFSL. This *"recommendation"* is designed to throw so much sand in the gears that class actions will never commence, to the significant benefit of corporations that have broken the law.

[21] *Allen* at [102].
[22] V Morabito, "Group costs orders and funding commissions", January 2024, p. 19.
[23] Menzies Research Centre, "Open Lawfare: How Australia became the lawfare capital of the world", July 2024, page 47.
[24] V Morabito, "Empirical Perspectives on Twenty-One Years of Funded Class Actions in Australia", April 2023, p. 29.
[25] See, for example, s 33V of the *Federal Court of Australia Act 1976* (Cth).

Leaving this aside, the *"key recommendation"* is fundamentally flawed. The Morrison government's legislation which created this requirement, has *already* been repealed, it should not be revived so shortly after. The reasons for the repeal of the initial legislation are sound and consistent with Federal Court authority. Relevantly:

(a) the explanatory statement to the repeal legislation makes plain that the MIS scheme was never drafted to capture litigation funders: *"the regulatory regime in the Act for regulating litigation funding schemes is not fit for purpose. Specifically, the MIS and AFSL regimes were not designed or intended to regulate the litigation funding industry"*;[26] and

(b) the Full Court of the Federal Court recently rejected the characterisation of litigation funding as a *Managed Investment Scheme* in *LCM Funding Pty Ltd v Stanwell Corporation Limited* [2022] FCAFC 103 at [7]: *"the characterisation of litigation funding arrangements as managed investment schemes is a case of placing a square peg into a round hole. It can only be done if one adopts an approach to statutory construction which atomises s 9 of the Corporations Act 2001 (Cth) …"*.

Accordingly, there is no basis to revise the repeal of legislation that has been so recently rejected.

5. The "return to class member fallacy" - the need for mandatory insurance disclosure

Each of SGS and the Menzies Research Centre point to historical returns to class members as a reason why litigation funding should be constrained. There are at least three irreducible objections to this argument:

First, class member "returns" are a function of the amount of compensation a defendant will pay, less legal costs and funding costs. They are not a function of the amount a defendant should pay. The reality is that many defendants cannot afford to pay the full amount of loss and damage caused to class members or are not willing to pay an amount which is even close to the actual loss and damage suffered. Consequently, engaging in a basic analysis which records net percentage returns to class members is fundamentally flawed. It ignores a defendant's capacity or willingness to pay. For example, the reason why the Federal Court approved a $16 million settlement in the *Dixon Advisory* class action is not because that was a reflection of the extent of the wrongdoing or total loss claimed, but because the defendant had limited funds (indeed, the first respondent entered into administration shortly after the class action was filed). As much was noted by the Court: *"the proposed Settlement Sum represents all the funds that the respondents have readily available to fund a settlement or satisfy a judgment"*.[27]

Second, potential "returns" often reflect the lack of *available* insurance limits to class members. For D&O insurance it is commonly the case that the defendant's legal costs *erode* the limit of indemnity, often times leaving paltry amounts of insurance cover left to pay just claims. Therefore, there exists a substantial incentive for defendants to run a *"Rolls-Royce"* defence with expensive, top-tier law firms, which sees the available amount of compensation available to pay class members eroded.[28]

Third, this analysis ignores the critical social benefit to the existence of funded class actions: access to justice. The 22 year period of funded class actions in Australia overwhelmingly demonstrates that, without litigation funding, class members would likely have received vastly less total compensation then they received.

[26] Explanatory Statement, Corporations Amendment (Litigation Funding) Regulations 2022 (Cth).
[27] *Watson & Co Superannuation Pty Ltd v Dixon Advisory and Superannuation Services Ltd* [2024] FCA 386 at [21].
[28] *Voxson Pty Ltd v Telstra Corporation Limited (No 8)* [2017] FCA 1427 at [16].

A better solution to maximising returns to class members would involve requiring defendants, at an early stage of the proceedings, to disclose potentially responsive insurance arrangements. That would enable class members to determine (on advice) whether their claim had a sufficient prospect of recovering funds to proceed with.

6. Costs Shifting – those who *commit* the wrong should *pay* for the wrong

Australia adopts a model of "costs-shifting". This means that where a plaintiff (or defendant) is successful at trial, the other (losing) party is usually ordered to pay their costs. This feature benefits both plaintiffs and defendants and is a hallmark of fairness in our legal system, representing the principle that the party who is at fault should pay the costs of the party who has suffered the harm.

In class action litigation, the litigation funding costs are not recoverable from the defendant, even if the plaintiff wins at trial. Instead, the funding charges are deducted from the gross returns to class members leaving them with a net amount (damages sum, less legal costs, less funding costs). As with legal costs, AALF considers that fairness requires that funding costs should be paid by unsuccessful defendants. This reflects the reality that class members claims are often unable to be prosecuted without assistance from litigation funders.

Class members, who have suffered a loss, should not have to pay for foreseeable losses caused by the defendants who have committed the wrongdoing. This would also create a powerful incentive for defendants to pay just claims, sooner.

7. Budget caps – level the playing field

The final point relates to the often superior resources of large defendants. In order to avoid the unnecessary erosion of insurance limits, and to prevent defendants "grinding down" plaintiffs a similar regime should be adopted to the United Kingdom where Costs Management Orders are made in complex litigation.[29]

Costs Management Orders seek to ensure proportionate, reasonable and proactive costs management by having a court approve detailed costs budgets submitted by all parties to litigation.

Costs Management Orders will prevent defendants from "grinding-down" plaintiffs by engaging in unnecessary interlocutory disputes, obtaining unnecessary evidence (often by costly experts) and engaging in spurious and costly appeals. This is also consistent with the "overarching purpose" stated in Court Civil Procedure Rules, which seek to ensure that civil litigation is managed in a way that endeavours to achieve a just, quick and cheap resolution of the relevant dispute. This change would benefit all parties and reduce the burden on Courts and therefore the public purse.

8. The myth that litigation finance is a tool of foreign interference

As if straight from the pen of Ian Fleming, SGS and the Menzies Research Centre have recently added a bizarre new claim to their pile of grievances relating to class actions and litigation funding: they suggest that both could be tools used by States such as Russia and China to attack and undermine Australian interests.[30] This would appear to be a creative re-tooling of the argument first made in

[29] See, Part 68 as introduced into the *Civil Procedure Rules 1998* by the *Civil Procedure (Amendment No.3) Rules 2024*.
[30] "Sinister Lawsuits: Security threat warning" Courier Mail, 29 October 2024.

America, that Russia and China may use litigation funding to abuse the American Court system and steal intellectual property from US Corporations.

These claims are as speculative as they are meritless. There is simply no basis to suggest that this has or could occur. Indeed, the Courier Mail article appears to cite as an example of the suggested risk, the (lawful) activities of the Environmental Defenders Office and the suggestion that foreign interests may be backing the EDO in its activities. It is not clear how litigation funding is implicated in this example. However, the example is apposite to ask the question: do foreign interests, such as major multinational corporations who might seek to run rough-shod over everyday Australians, contribute financially to the activities of the SGS or Menzies Research Centre?