Association of Litigation Funders of Australia

Submission to Treasury and the Attorney-General's Department

Response to the *Exposure Draft of the Treasury Laws Amendment (Measures for Consultation) Bill 2021: Litigation funders*

15 October 2021

About the Association of Litigation Funders of Australia

The Association of Litigation Funders of Australia (**ALFA**) is a professional body established in April 2018 to enhance the Australian litigation funding market by:

- providing education, training and information about litigation funding and the litigation funding market;
- engaging with government, legislators and other policy makers to help shape the legal and regulatory framework of litigation funding in Australia; and
- promoting best practice and ethical behaviour amongst litigation funders in Australia.

The members of ALFA are Augusta Ventures, Balance Legal Capital, CASL, Court House Capital, Investor Claim Partner, Ironbark Funding, Litigation Lending Services, Premier Litigation Funding, Southern Cross Litigation Finance and Vannin Capital.

This submission is made on behalf of the members of the Association and represents their collective views, but it does not necessarily represent the individual views of each member.

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Executive summary of ALFA's principal concerns with the Exposure Draft

Since 2020, the Federal Government has introduced several legislative reforms aimed at litigation funding schemes and their associated costs. This included removing the managed investment scheme and other financial services regulatory exemptions from litigation funders, exposing them to increased legislative oversight. Whilst ALFA anticipates that these reforms will increase the cost of conducting class action proceedings, their exact impact is currently unknown – it is simply too early to be precise.

Most recently, on 30 September 2021, the Federal Department of Treasury released for consultation the exposure draft titled *Treasury Laws Amendment (Measures for Consultation) Bill 2021* (**Exposure Draft**). The Exposure Draft gives effect to a range of recommendations made by last year's Parliamentary Joint Committee inquiry into the class action industry.

In a joint media release, The Hon Josh Frydenberg MP stated that the proposed legislation would "*promote a fair and reasonable distribution of class action proceeds in proceedings involving a litigation funder*". The ALFA considers that the current formulation of the Exposure Draft will not achieve this objective and suffers from a number of serious defects.

This submission sets out the five most concerning aspects of the Exposure Draft. These are:

1. **Access to justice** – The proposed cap of 30% on fees will limit the financial viability of running class actions. Class actions which have high social utility but are more expensive or risky to run may not progress, undermining the purpose of the class action regime in Australia and limiting the exposure of companies and executives to only those proceedings which would be relatively cheap or less risky to run. This also encourages defendants to incur higher legal costs to force a more favourable settlement, resulting in higher overall legal costs, which is economically inefficient. This issue is not fully ameliorated by the fact that later amendment is permissible under s 601LG(1)(b).

2. **Fettering of court's discretion** – It is undesirable to fetter the Court's discretion when determining if a claim proceeds distribution method is fair and reasonable under s 601LG(3), given the Court will determine the rights of the class members to settlement funds according to this criterion. Where the discretion is fettered, and the class members are bound by the Court's decision, it may negatively affect their rights of recovery.

3. **Multiplicity of proceedings and finality** – The closed class approach will likely lead to multiplicity of proceedings as not all possible group members would be bound by the court's decision. This also has implications for the finality of decisions where the same or similar factual matters arise for consideration in multiple cases.

4. **Early determination of distribution method** – The requirement to specify the distribution method in a scheme's constitution is problematic in circumstances where the likely basis of recovery may not be known with certainty until much later in the proceedings. So too is early approval of such a method. This issue is not remedied by the possibility of later amendment under s 601LG(1)(b).

5. **General unworkability** – There are also a number of definitional and cohesion issues with the *Federal Court of Australia Act 1976* (Cth) (**FCA Act**) which undermine the operation of the proposed legislation.

We also note that constitutional issues may arise in respect of s 601LF(4) and the application to States not exercising federal jurisdiction. This issue should also be properly considered.

Introduction

1 ALFA's members operate in the class action sector and together have a deep understanding of the existing legislation and its practical application, awareness of the challenges facing the industry as well as an interest in a class action regulatory regime that is fit for purpose.

2 ALFA makes this submission in response to the Exposure Draft released on 30 September 2021 by the Federal Department of Treasury for consultation. The consultation period was only seven days long. That period was insufficient for the ALFA to prepare a substantive response. Accordingly, this submission sets out five of the most concerning aspects of the Exposure Draft, though these are not the extent of ALFA's concerns.

3 In making this submission, ALFA reiterates the matters raised in its previous submission to Treasury and the Attorney-General's Department during the consultation period on the topic of guaranteeing a minimum return of class action proceeds to class members dated 5 July 2021 (**Consultation Paper**).

Issue 1 – Access to justice

4 The federal class action regime established by Part IVA of the *Federal Court of Australia Act 1976* (Cth) (**FCA Act**) was introduced with the aim of improving access to justice by enabling people with small claims that would be uneconomical to bring individually, to bring their claims concurrently in a single proceeding.[1] Key to this regime is the sharing of costs between many group members.

5 The Australian Law Reform Commission observed that the original class action regime left unanswered the difficult questions of who would pay for these costs and how to relieve the representative applicant from the risk of an adverse costs order should the proceeding fail.[2] Commercial litigation funding is now an established part of class action proceedings in Australia and provides a mechanism to cover these costs.

6 The Exposure Draft seeks to further address this funding question by determining what is a "fair and reasonable" distribution of the class action proceeds by granting courts a specific power to vary funding agreements where legal and funder costs are perceived not to meet the fair and reasonable threshold. It does this by creating a rebuttable presumption that a return to group members of less than 70 per cent of the total claim proceeds for the scheme is not fair and reasonable. That is, there is in effect, a proposed cap on fees, comprising both legal and funder fees and a return on investment. It is yet unknown what evidence will be sufficient to rebut such a presumption.

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1 Second Reading Speech by Attorney-General, House of Representatives, 14 November 1991, *Hansard*, at 3174-3175.

2 *Proceedings and Third-Party Litigation Funders*, Final Report, December 2018, at 49.

7 PwC research into recent class action settlements cited in ALFA's Consultation Paper shows that:

(a) a cap of 30% on total costs would have had implications for 91% of cases, where total costs (both the litigation and funding costs) exceeded 30% of gross proceeds; and

(b) in 36% of cases, litigation costs (ie, legal fees and disbursements) alone exceeded 30% of gross proceeds, which would make these claims unviable if the proposed Bill takes effect.

8 These figures demonstrate that many class actions would be limited by the cap proposed. But the cap, over the long term, is unlikely to have the effect of reducing costs and increasing the proportionate return to consumers. This is true for at least the following reasons.

9 *First*, our adversarial civil justice system broadly requires equality of arms to achieve justice. Legislative capping of claimants' costs without equal economic restrictions on defendants' costs is inimical to equality of arms and therefore justice.

10 *Second*, defendants will be encouraged to run "scorched earth" defences, where they pursue every legal point possible and engage in costly interlocutory applications in the hope that the plaintiff's costs will increase close to or over the 30% mark, making the continuation of proceedings financially unattractive. While the avoidance of further costs may be a legitimate reason to settle proceedings, it assumes parties have run proceedings efficiently. A 30% cap will cause a perverse incentive for the incurring of unnecessary costs, inconsistently with the court's overarching purpose – the just, quick and cheap resolution of disputes. Further, the impact of the cap is exacerbated by the costs associated with the Managed Investment Scheme regime, the full extent of which is currently unknown.

11 *Third*, even where proceedings are efficiently run, the cap may have the unintended effect of increasing settlement expectations of plaintiffs, requiring defendants to pay more if they wish to resolve class actions before trial. That is, plaintiffs may come to expect a 30% cap, meaning that settlements could only occur at and around that figure even if they would otherwise have settled for less. This again introduces cost inefficiencies that will be borne by group members.

12 *Fourth*, over time, as less funders remain in the market because of the reforms, the costs of providing funding services will inevitably go up as competition is reduced. This would eventually be passed onto consumers in the form of higher costs.

13 *Finally*, while s 601LG(1)(b) of the Exposure Draft permits the variation of a claim's distribution method, that does not necessarily overcome the issues outlined above. For example, where the rebuttable presumption arises and is applied at a relatively early stage of the proceedings, this may have the effect of forcing the discontinuance of proceedings where that variation would make proceedings financially unviable. This is problematic particularly where, had this assessment been made at the conclusion of proceedings, once the actual distribution method was known, a different percentage figure would have been determined to be fair and reasonable being one that would have permitted the proceedings to continue. In this way, the proposed system will mean viable claims are not to be pursued.

14 Variation would also require an amendment to the scheme constitution, given that funded class actions are, by definition a Managed Investment Scheme. The variation process can be costly. Those costs will necessarily be passed onto group members. Where variation at an early stage is in fact unnecessary, such costs are unjustifiable.

15 There are several other issues also affecting access to justice.

16 The presumption creates uncertainty. Funders are unlikely to dedicate further resources to a proceeding which, at the early stage, it considers it will incur costs at or above the 30% mark and so be subject to the presumption. The possibility of rebuttal is unlikely to overcome the chilling effect of the presumption prior to proceedings commencing. This is particularly concerning where egregious conduct is alleged. If the quantum of return is of less concern to group members than addressing the injustice of that conduct and ensuing accountability, the cap may unjustifiably limit the viability of such claims. Issues such as the desire to ensure accountability are not permitted to be considered by the court in determining whether a claim distribution method is fair and reasonable.

17 It should also be noted that litigation funders do not generally fund cases on an individual basis, but rather fund a portfolio of cases allowing them to diversify their risks. The greater the diversification across the portfolio, the greater the additional risks (i.e. cases) that a funder can take while maintaining an adequate expected rate of return across the portfolio. A reduction in the available return to litigation funders across their portfolios, and a narrowing of the types of class actions that are commercially viable to run, will reduce the ability of some litigation funders to fund the types of riskier class actions involving the most disadvantaged claimants or novel areas of the law.

18 Litigation funders also have fixed costs, including employing highly skilled specialists to assess potential cases and manage their investments in class actions. To remain economically viable, litigation funders not only need to generate returns from their existing cases, but also need to fund new cases on behalf of investors who provide capital. Reduced rates of return and fewer class actions available to fund will likely lead to investors withdrawing capital from funders, leading to some litigation funding businesses becoming uneconomic and exiting the Australian litigation funding market entirely. This would reduce competition in the funding of class actions and ultimately result in higher costs for group members.

19 The effect of all of this is that class actions with high social utility may not progress, undermining the purpose of the class action regime in Australia and limiting the exposure of companies and executives to civil accountability.

20 Overall, access to justice will be diminished by the legislation proposed in the Exposure Draft.

Issue 2 – Fettering of Court's discretion

21 Proposed s 601LG(3) would fetter the court's discretion by requiring that the court "only" have regard to the matters listed in that section. Such a limitation is extraordinary and, in our submission, is an impermissible overreach of the legislature into the domain of the independent branch of the judiciary.

22 It is undesirable to fetter the Court's discretion when determining if a claim proceeds distribution method is fair and reasonable because those words necessarily draw their meaning from context. By limiting the factors that may be considered that context is narrowed, and the determination accordingly limited. If the aim is to ensure fairness and reasonableness, the court must be able to consider all matters relevant to that question. Any determination that does not consider all relevant matters cannot, be fair and reasonable. In this way, the Exposure Draft ensures unfairness while purporting to seek it.

23 The concepts of "fairness" and "reasonableness" frequently arise, and courts are adept at considering them. No evidence has been proffered suggesting that the courts have miscarried in this task, requiring the intervention of the legislation. This is a clear case of legislative overreach.

24 The limitation on what is fair and reasonable is also relevant because the court will determine group members' rights to settlement funds according to this criterion. Where the discretion is fettered in this way, and the group members are bound by the court's decision, it may negatively affect their rights to the quantum of recovery. Again, this may in fact reduce fairness rather than ensure it.

25 The provision for additional factors in regulations does not overcome this issue. It simply provides additional criteria for consideration. It does not remove the fetter on the Court's discretion.

Issue 3 – Multiplicity of proceedings and finality

26 The Exposure Draft proposes to introduce an opt-in scheme for funded class action proceedings. Opting-in requires agreement to the funder's terms in writing. Those who do not opt-in would not be bound by the decision of the court. Such persons would then be free to bring proceedings in relation to the same claims. This creates the risk of multiplicity of proceedings, particularly where many potential group members have not opted-in, and the initial funded proceeding was successful. While this is also possible in the opt-out regime under Part IVA of the FCA Act, it is less likely as all people meeting the group definition will be bound by the decision unless they opt-out in writing.

27 Where there are multiple proceedings, particularly where the facts or claims are not identical to other representative claims, it may be that the same or similar questions of fact or law come before different courts and judges, possibly resulting in conflicting determinations of those matters. This is antithetical to the current judicial approach and undermines finality of court decisions as appeals may lie from inconsistent decisions.

28 The opt-in approach also makes necessary a sufficient number of group members who have signed the funding agreement to cover the costs of the proceedings. This is known as "book building". Book building is expensive. Those expenses must be carried by someone, which will most likely be the group members. Book building is also contrary to the intention underlying the opt-out model adopted by Part IVA of the FCA Act.

29 Finally, multiplicity of proceedings means that defendants may face repeated litigation for the same or similar matters. This is unfair and inefficient.

Issue 4 – Early determination of distribution method

30 The requirements for a claim proceeds distribution method to be approved at an early stage of proceedings creates several difficulties.

31 *First*, it is incredibly difficult if not, in most cases, impossible to accurately determine at the outset exactly what any claim proceeds distribution method will entail as it will depend on events during the proceedings. This aspect of the proposal is therefore, as a practical matter, simply unworkable. It was also one of the reasons the High Court in *BMW Australia Ltd v Brewster; Westpac Banking Corporation v Lenthall* (2019) 374 ALR 627, indicated that common fund orders at an early stage of proceedings were inappropriate, as all the factors relevant to considering whether such orders were fair and reasonable could not then be known.

32 *Second*, it will in all likelihood mean that any such method contained in the initial scheme documents will be generic and non-specific in nature. Approval by the court would necessarily need to be revisited when settlement parameters become known, and the precise distribution method can be set out with more detail and certainty. The requirement for early approval then adds nothing to the process other than additional costs and uncertainty for funders.

33 *Third*, distribution methods are ordinarily determined by lawyers acting for group members. This role should be retained by lawyers who owe fiduciary obligations to those clients. The requirement that the method be included by funders in their agreements removes this safeguard.

34 In our submission, the existing usual practice of requiring that notices be sent to group members during proceedings already requires early notification of the kinds of distribution schemes that may be adopted in the event of successful litigation. Such a practice is to be preferred and has already been proven effective.

Issue 5 – General unworkability

35 There are also a number of issues that suggest a general unworkability of the Exposure Draft. Two are set out below.

36 A number of definitional issues undermine the operation and scope of the proposed legislation. These include the definition "*Class action litigation funding scheme"* (s 9AAA) which would have the effect of extending the reach of the Exposure Draft far beyond class actions. This occurs by the re-characterisation as "class action litigation funding schemes", any litigation in which a non-lawyer third party provides financial assistance or indemnity to a litigant. This would include many unintended parties including philanthropic non-profit entities that provide limited indemnities in respect of adverse costs orders without any payment or commercial return.

37 Further, possible issues may arise from the interface between the current Part IVA of the FCA Act and equivalent state Acts and the proposed legislation. This results principally from the fact that the proposed legislation is to be incorporated into the *Corporations Act 2001* (Cth) and does not appear to have been well integrated with that scheme. For example, the Part IVA scheme under the FCA Act and its equivalents create an opt-out scheme. How the opt-in scheme

proposed by the Exposure Draft will operate concurrently with applicable provisions of Part IVA is unclear. This should be clarified.

Conclusion

38 In conclusion, ALFA submits that the appropriate course, in light of the serious issues raised above, is that the Exposure Draft be removed to the relevant parliamentary committee for further review and amendment.

39 That such serious issues arise in circumstances where the consultation period on the Exposure draft was only seven days long raises serious questions about the approach taken by the Federal Government. We do not consider that this time frame is consistent with the Office of Best Practice Regulation guidelines, nor is it appropriate to enable genuine consultation. Proper consultation should be undertaken once a further revised draft is formulated.