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5 July 2021

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By email: MCDLitigationFunding@treasury.gov.au

Dear Sir or Madam

Guaranteeing a minimum return of class action proceeds to members

1. Phi Finney McDonald welcomes the opportunity to make a submission in response to the joint Treasury and Attorney-General's Department Consultation Paper entitled *"Guaranteeing a minimum return of class action proceeds to class members"*, dated June 2021. Our responses to the Consultation Questions appear in the table below. Background information and analysis are provided in the body of the submission.

Consultation Question One:

What is the best way to guarantee a statutory minimum return of the gross proceeds of a class action (including settlements)?

Response:

The requirement to register every funded class action as a Managed Investment Scheme (**MIS**) has reversed the growing competition in the litigation funding market that, prior to the government's intervention, was reducing cost of litigation funding. The *Corporations Amendment (Litigation Funding) Regulations 2020* (**Regulations**) have also imposed a considerable regulatory burden on litigation funders, the costs of which will be passed on to consumers.

By disrupting the third-party litigation funding market, the Regulations have provided a competitive advantage to large plaintiff law firms like Maurice Blackburn and Slater & Gordon.

Treasury warned of these consequences in a 2015 review that counselled against applying the Australian Financial Services Licence (**AFSL**) and MIS regimes to funded class actions. More recently, the Parliamentary Joint Committee on Corporations and Financial Services (**PJCCFS**) also acknowledged the MIS regime is not fit for the purpose of regulating funded class actions in recommendation 28 of its report on litigation funding and the regulation of class actions.

Phi Finney McDonald supports the Regulations being amended to exempt a litigation funding arrangement from the AFSL and MIS regimes if the arrangement guarantees that group members will retain at least 70 per cent of the gross litigation proceeds. This is not a proposal

for a statutory price cap. Rather, it is a proposal to temper the impact the Regulations have had on increasing price.

This is consistent with the proposal that Senator Pauline Hanson put forward to the government in November last year.

Phi Finney McDonald maintains that the exemption is appropriate and will produce the best result for group members. The exemption will promote competition in a judicially regulated environment and by limiting the regulatory impact to those higher risk (and therefore more expensive) claims where the exemption is not invoked.

It will create a strong incentive for the market to engage in price competition. It will allow third-party funded claims to better compete with the unfunded and contingency fee-based class actions brought by Maurice Blackburn and Slater & Gordon, whose market power has increased and will continue to increase due to the government's intervention in the market.

Phi Finney McDonald has discussed the proposed exemption in briefings with Coalition and crossbench parliamentarians. We understand that some parliamentarians are philosophically opposed to statutory price controls, and some were interested in a pragmatic amendment that retained the overarching structure of the Regulations whilst avoiding the worst of their anti-competitive impact.

If implemented, the exemption would free the market to determine the price of litigation funding. It would remove government red-tape and lessen the burden on public resources. It would allow more funders to confidently compete with an unregulated class action run by a large plaintiff law firm. The already fierce level of judicial regulation of funding arrangements and class action settlements would be retained. And price competition would be encouraged, ensuring that neither law firms nor funders stood to receive windfall gains from strong claims.

Funders would be able to put forward arrangements that did not guarantee that group members would receive 70 per cent of gross recoveries. However, the AFSL and MIS regimes would apply to those arrangements, and group members would receive the heightened product and financial services disclosure that the government regards as beneficial.

The exemption would convert the Regulations from an 'ill-fitting' regime that increased costs and reduced competition, into one that allowed lawyers and funders to avoid the regime if they lowered their prices.

An arbitrary price cap cannot adequately cope with the complex risks involved in commencing a class action. Imposing any statutory price cap risks the introduction of a 'default price' – removing any incentive to compete. A low statutory price cap (such as 30%) will result in worthy but complex, or lower value, class actions not being commenced at all. This would deprive the victim of misconduct of *any* recovery of their losses. The only beneficiary of this is the perpetrator who would not be required to make any form of restitution to those harmed.

A low statutory price cap would also make it harder for firms like Phi Finney McDonald to negotiate litigation funding at rates *lower* than the cap. Prior to the introduction of the Regulations, it was possible to negotiate lower rates particularly in larger or more straightforward claims. Under the Regulations, and with a low price cap, funders can

reasonably be expected to look to those larger or more straight forward cases as an opportunity to subsidise other cases it is funding or to offset losses.

By providing an exemption from the AFSL and MIS regimes, the government would be promoting a market-based solution through a regulatory incentive. It would facilitate a more competitive, lower cost, and more mature litigation funding market that will continue to be complemented by strong court oversight.

Consultation Question Two:

How would the suggested mechanism interact with the class action system (including court processes) and the litigation funding regime?

Response:

Exempting class actions that guarantee 70% group member returns from the AFSL and MIS regimes would achieve the purpose of the Regulations by applying downward pressure on prices.

This would be further boosted by the government implementing the Australian Law Reform Commission's recommendations in relation to greater powers and enhanced procedures for the Federal Court of Australia in supervising the conduct of funded class actions, as contained in the ALRC's report, *Integrity, Fairness and Efficiency – An Inquiry into Class Action Proceedings and Third-Party Litigation Funders*.

Consultation Question Three:

Is a minimum gross return of 70 per cent to class members the most appropriate floor for any statutory minimum return? If not, what would be the appropriate minimum and its impact on stakeholders, the class action system and the litigation funding industry?

Response:

It would not be appropriate to set any form of statutory minimum, but a 70% floor would be particularly inappropriate given its impact on access to justice.

Exempting class actions that guarantee 70% group member returns from the AFSL and MIS regimes would achieve the government's stated objective of improving group member returns. It would also do so in a manner that was consistent with the government's broader free market ideology.

Any arrangement that failed to satisfy the 70 per cent gross minimum threshold would not attract the benefit of the regulatory exemption. The AFSL and MIS regime would apply with full force, and ASIC's scrutiny would be more targeted.

Consultation Question Four:

Is a graduated approach taking into consideration the risk, complexity, length and likely proceeds of the case appropriate to ensure even higher returns are guaranteed for class members in more straightforward cases?

Consultation Question Five:

How would a graduated approach to guaranteed returns for class members be implemented? This can include how a decision is made that a particular case is straightforward, how cases could best be classified to determine the minimum return applicable to a particular case and at what stage of an action such a determination should be made.

Response:

Statutory price caps will further undermine competition in the litigation funding market.

This will benefit defendant companies and their insurers by reducing the ability of 'Quiet Australians' to recover compensation for wrongdoing.

The cases that do proceed will be more expensive absent competition. The primary financial beneficiaries of this market interference will be large litigation funders, as well as the large plaintiff law firms that have historically been most vocal in their opposition to the government.

The government should be encouraging market pressure and competition as the best means of improving returns to class action group members – a fully informed participant should be allowed to choose a price structure rather than not have their day in court at all.

Exempting class actions that guarantee 70% group member returns from the AFSL and MIS regimes would encourage arrangements that guarantee that group members retain **more** than 70 percent of the gross litigation proceeds. Phi Finney McDonald has been able to negotiate funding structures that guarantee that 80%, 82% and 91% of gross proceeds will be distributed to group members. That was only possible because of healthy competition between funders, which has been reduced by the Regulations and which will be reduced further by a hard statutory price cap.

As a matter of principle, the risk, complexity, length and likely proceeds of a case should and do impact upon the cost of litigation funding. However, this is fundamentally a commercial decision that cannot be pre-made at a universal level by a government. It is impossible for legislation to prospectively and universally prescribe how such factors should be weighed in any case.

Further, the Courts are already stress-testing the reasonableness of settlement outcomes by reference to those factors. The Courts, supported by competitive market forces, are best placed to ensure that group member returns are increased wherever possible, and particularly in more straightforward cases. Exempting class actions that guarantee 70% group member returns from the AFSL and MIS regimes will assist in this outcome.

Consultation Question Six:

What other implementation considerations would be relevant to the issues raised in this consultation paper? Please provide examples.

Response:

Exempting class actions that guarantee 70% group member returns from the AFSL and MIS regimes would avoid any need to exempt some classes of litigations funders such as charitable litigation funders.

Avoiding the need for class-based exemptions reduces the likelihood of gaming. It avoids new litigation funders being structured around charitable exemptions, and the need for ASIC to stress test their bona fides.

Class actions funded by the Australian Farmers Fighting Fund would fall within the exemption and would not need to have an artificial class created around it so as to justify that outcome.

Background

2. The perceived need for measures to address the cost of funding commissions and ensure class action group members retain a larger share of litigation proceeds attracted fresh attention in 2020.

3. This attention was prompted by two key developments. The first was the establishment of the PJCCFS inquiry into Litigation Funding and the Regulation of the Class Action Industry, following a 13 May 2020 referral from the House of Representatives subject to Terms of Reference moved by the then Attorney-General the Hon Christian Porter MP.

4. The second development was the announcement on 22 May 2020 by Treasurer the Hon Josh Frydenberg MP that litigation funders would be required to obtain an AFSL and comply with the MIS regime, pursuant to the Regulations which came into force on 22 August 2020.

5. While the Government's concern with the litigation funding industry was ostensibly prompted by a desire to reduce litigation funding commissions and increase group member returns, the Regulations had the opposite effect.

6. While some litigation funders have now obtained an AFSL, the need to register and operate every individual funded class action as an MIS remains problematic and is reducing competition between funders and law firms in relation to particular cases. It is that competitive tension that brought the price of litigation funding in recent times. The PJCCFS itself acknowledged that the MIS regime is not fit for the purpose of regulating funded class actions, reflecting the concerns of industry.

Policy options for guaranteeing minimum group member returns

7. During the PJCCFS inquiry, a number of options were floated that were intended to improve returns to class action group members.

8. Omni Bridgeway was the first to propose a statutory price cap. In its 17 June 2020 submission to the PJCCFS inquiry, it urged the Government to:

> *"Introduce legislation to require a minimum return to group members in a funded Australian class action of no less than 50 per cent of the gross proceeds from the action* (our emphasis).

9. More recently, Omni Bridgeway commissioned PwC to produce a report examining the impact of a 50 per cent price cap in comparison to a nominal 30 per cent price cap (**PwC report**). This PwC report featured in a column published in the Australian Financial Review on 16 March 2021, which reinforced Omni Bridgeway's push for a 50 per cent price cap:

> *"Omni Bridgeway is advocating for a 50 per cent cap - or a 50 per cent floor on member returns - which, according to the report, would make only 12 per cent of cases unviable and put about 33 per cent cases in doubt.*
>
> *"In Omni Bridgeway's view, a 50 per cent minimum return for members strikes the right balance, beyond which the courts and their expert advisers are best placed to remain the arbiter of the reasonableness of returns to a litigation funder," Mr Saker said.*

10. Phi Finney McDonald opposes a statutory price cap. If the government and cross benchers, however, are committed to the AFSL and MIS regime continuing in full force, and decide to proceed with a hard statutory price cap, then Phi Finney McDonald:

    (a) agrees that a hard 30% price cap would reduce access to justice and render worthy claims economically unviable; and

    (b) accepts that a 50% price cap would likely minimise that economic impact.

11. However, Phi Finney McDonald's position is that statutory price caps do not achieve the stated policy objective. Lowering the cost of class actions will be achieved through the combined effect of heavy judicial scrutiny and healthy tension in a highly competitive market. Further, Federal and Supreme Court Judges already routinely pressure if not require lawyers and funders to reduce their fees in order to ensure a proportionate net return to group members (with 50% of gross sums acting as a proxy).

12. Phi Finney McDonald believes that competition in a free market is the best way of reducing prices. This would be achieved by exempting class actions that guarantee 70% group member returns from the AFSL and MIS regimes.

13. On 11 November 2020, Senator Hanson issued a media release:

> *"...proposing to allow third parties who fund legal actions, to avoid ASIC licencing if litigants are guaranteed at least 70% of the gross court awarded compensation payouts...*
>
> *"Senator Hanson is proposing that litigation funders be exempt from being licenced if they guarantee successful litigants receive the larger portion of any award. Senator Hanson is pushing for the changes through an amendment to the Corporations Act regulations regarding litigation funding"* (our emphasis).

14. Senator Hanson also referenced the proposed exemption for litigation funding arrangements that guarantee *"a minimum payout of 70 per cent"* during the Senate debate into the proposed disallowance of the Regulations.

15. Contrary to their stated purpose, the AFSL and MIS regulations will increase the cost of class actions by reducing competition. Introducing a statutory price cap will make this worse. It will ensure that worthy but smaller class actions are not commenced, and that Quiet Australians are denied their day in Court. The better course is to exempt litigation funding arrangements from the AFSL and MIS regimes where group members are guaranteed to receive 70% of recoveries. This will result in lower cost class actions and avoid reducing access to justice.

16. Thank you for affording Phi Finney McDonald the opportunity to make a submission in relation to the Consultation Paper. If we may be of any further assistance, please do not hesitate to contact me at enquiries@phifinneymcdonald.com.

17. We note that on 4:38pm on Friday 25 June 2021 Vaishali Davé of the Treasury confirmed by email that the time for providing a submission in response to the Consultation Paper had been extended until 5 July 2021.

Yours sincerely

Ben Phi
Managing Director
PHI FINNEY MCDONALD