Ai GROUP SUBMISSION

Australian Government
The Treasury

Treasury Laws Amendment (Measures for Consultation) Bill 2021: Litigation funders

6 October 2021

Introduction

The Australian Industry Group (**Ai Group**) welcomes the opportunity to make a submission on the *Treasury Laws Amendment (Measures for Consultation) Bill 2021: Litigation Funders* (**Litigation Funding Bill**) and the *Corporations Amendment (Litigation Funding) Regulations 2021* (**Litigation Funding Regulations**).

Ai Group and our members have a significant interest in the proposed reforms. Businesses are being targeted in a class action boom that is being driven by litigation funding firms that are pursuing excessive profits at the expense of businesses, plaintiffs and the broader community. Insurance costs for businesses, driven by the large increase in class actions in Australia, have risen by up to 600 per cent.[1]

Those opposing reforms to class action and litigation funding laws often dress up their arguments with liberal references to access to justice in order to take the focus off the excessive profits that they are earning from class actions. Implementing carefully considered changes to class action laws to achieve a fairer outcome for plaintiffs and businesses, will not impede access to justice. The current laws are only operating in the interests of litigation funders and the law firms they are partnering with.

A recent Australian Law Reform Commission report on class actions proceedings and third-party litigation funders reported that in cases involving litigation funders, the median return to plaintiffs was only 51 per cent of the amount awarded, while in cases not involving litigation funders, the median return to plaintiffs was 85 per cent.[2]

Class actions have a genuine role to play in ensuring that where a large number of parties have suffered common harm or damage, they are properly compensated. However, the current poorly regulated system is allowing litigation funders to take a disproportionate share of any award or settlement.

Ai Group has recently made the following submissions calling for reforms to class action and litigation funding laws:

- Submission to the Parliamentary Joint Committee's Inquiry into Litigation Funding and the Regulation of the Class Action Industry (**PJC Inquiry**) (15 June 2020);
- Submission responding to the Consultation Paper: *Guaranteeing a minimum return of class action proceeds to class members*, prepared by the Treasury and the Attorney-General's Department (28 June 2021); and
- Submission on the proposals in Consultation Paper 345 – *Litigation Funding Schemes:*

[1] Submission of Marsh to the PJC Inquiry, 11 June 2020.

[2] Australian Law Reform Commission, *Integrity, Fairness and Efficiency—An Inquiry into Class Action Proceedings and Third-Party Litigation Funders* (Final Report), December 2018. Published in Parliament on 24 January 2019.

Guidance and Relief, published by the Australian Securities and Investments Commission (20 August 2021).

By effecting targeted reforms to implement a number of important recommendations of the PJC Inquiry into litigation funding and the regulation of the class action industry, the Litigation Funding Bill and the Litigation Funding Regulations compliment necessary amendments made by the *Corporations Amendment (Litigation Funding) Regulations 2020* which require operators of litigation funding schemes to hold an Australian Financial Services Licence and subject litigation funding schemes to the managed investment scheme (**MIS**) regime in Chapter 5C of the *Corporations Act 2001* (Cth) (**Corporations Act**).

Ai Group strongly supports the Litigation Funding Bill and Litigation Funding Regulations.

Considering the transitional provisions proposed for insertion in Chapter 10 of the Corporations Act which confirm that the reforms are not retrospective, it is important that the Litigation Funding Bill is passed by the Australian Parliament without delay and that the Litigation Funding Regulations are made as soon as possible.

Class members should consent to litigation funding agreements

The Litigation Funding Bill would ensure that prospective class members are not 'railroaded' into participating in class actions without their consent. The necessary amendments include:

- Limiting 'general members' to those claimants in a class action who have agreed in writing to enter the scheme and be bound by the terms of the scheme's constitution (s.601GA(5)(a));

- Requiring litigation funding schemes to have a constitution which includes a claim proceeds distribution method (s. 601GA(5)(b)); and

- Ensuring that funding agreements for class action litigation funding schemes are not enforceable and have no effect if the Court makes a common fund order (s. 601LF).

The availability of common fund orders encourages speculative litigation as such orders remove much of the expense of 'book building' and remove the danger that insufficient class members will agree to the funder's commission. There are very few other circumstances under which such significant legal rights are waived without an individual's express or implied consent.

The reforms proposed appropriately deal with the incentive for funders to sign class members up without their knowledge or understanding of their rights.

Subjecting funding agreements to the laws of Australia

The increased prevalence of foreign litigation funders being involved in Australian class actions necessitates appropriate reforms geared toward ensuring that such funders are subject to agreements bound by the laws in force in a particular State or Territory of Australia.

The Litigation Funding Bill would ensure that litigation funding schemes are bound by a constitution which provides that each funding agreement for the scheme must:

- Include words to the effect that the agreement is subject to the law in force in a particular State or Territory (s. 601GA(5)(c)(i)); and
- Include words to the effect that the only courts in which the agreement can be enforced are the courts of the Commonwealth or the courts of a particular State or Territory (s.601GA(5)(c)(ii)).

The substantial growth in the number of class actions in recent years is an unfortunate by-product of inadequate regulation of litigation funders, many of which are based overseas and target Australian employers due to the lack of appropriate oversight of their activities. As stated in the PJC Inquiry Final Report:[3]

> *11.57 If a foreign litigation funder seeks to profit from class action litigation in Australia, it is only appropriate that its funding arrangements are subject to, and in accordance with, Australian law. There should be no question as to the Federal Court's jurisdiction to adjudicate and resolve any issues arising from a litigation funding agreement pertaining to a class action in its own jurisdiction.*

Ai Group supports the proposed reforms to ensure that litigation funding agreements in class action proceedings are subject to Australian law and the jurisdiction of Australian courts.

Funders should pay the costs of litigation funding fees assessors and contradictors

There is significant benefit in ensuring that class members in funded proceedings are protected by ensuring that a Court has the benefit of an independent litigation funding fees assessor or a contradictor who assists and informs the Court's assessment of the claims distribution method.

[3] Report of the Parliamentary Joint Committee on Corporations and Financial Services' inquiry into litigation funding and the regulation of the class action industry, December 2020, [11.57].

The Litigation Funding Bill would put in place appropriate protections for plaintiffs by:

- Requiring that the Court consider the report of a person appointed to inquire into and report on the fairness and reasonableness of the claims distribution method or consider the representations of a contradictor representing the scheme's general members before making an order approving or varying a funding agreement for a class action litigation funding scheme, unless it is not in the interests of justice to do so (s. 601LG(6));

- Requiring the constitution of a class action litigation funding scheme to provide that any litigation funding agreement must contain an undertaking by the litigation funder to pay the reasonable costs of the fees assessor and the contradictor (s. 601GA(5)(d)).

These reforms would guarantee that, unless the circumstances otherwise provide, the Court is furnished with appropriate independent information to assist it in making an appropriate order under s.601LG. By imposing the cost of providing such assistance upon the litigation funder, a proportionate incentive is generated for the funder to moderate funding fees.

Appropriate limitations should be imposed on litigation funders' profits

The regulatory system governing litigation funding arrangements should ensure that the class action regime is not misused as an avenue for litigation funders to make unreasonable profits at the expense of class members and businesses.

As stated in the PJC Inquiry Final Report:

> *5.23 The data indicate that, in many cases, litigation funders are obtaining windfall profits well in excess of the risks they are taking. And those windfall profits are coming at the expense of the class members' share of the proceeds from a successful outcome. For example, the Attorney-General highlighted the Australian Law Reform Commission finding in its Final Report that 'when litigation funders were involved in a class action, the median return to class members was just 51 per cent, compared to 85 per cent when a funder was not involved'*
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> *5.24 To be clear, the incidence of windfall profits is not restricted to isolated instances of illegal or egregious behaviour. Rather, there appears to be a systemic and inappropriate skewing of the proceeds of a successful class action in favour of litigation funders at the expense of class members. This clearly fails the test of a reasonable, proportionate and fair division of the returns between class members, lawyers and litigation funders.*

Later in the Final Report, the Committee relevantly stated:

> *13.53 Litigation funders appear to be making windfall profits from Australia's class action system at the expense of class members and defendants. Litigation funders ought to be reimbursed for the costs incurred and make a profit which is reasonable and*

proportionate to the risk undertaken. However, the slice of settlement sums going to litigation funders is often disproportionate to the costs incurred and risk undertaken. The current percentage-based billing practice contained in litigation funding agreements enables windfall profits to be obtained. Currently, the difference between the capital a litigation funder has put at stake and the profit made is often unreasonable, disproportionate and unfair. The unfairness is primarily borne by the class members because their share of the settlement is significantly reduced by the excessive proportion going to litigation funders.

13.54 *The committee is not persuaded by the argument that it is better for class members to get 50 per cent of something with the involvement of a litigation funder, as opposed to 100 per cent of nothing without the involvement of a litigation funder. The committee considers that such arguments ignore the possibility that class members could receive substantially more than 50 per cent of something, with litigation funders still receiving a return that is reasonable, proportionate and fair for the risks they have taken.*

The Litigation Funding Bill would appropriately implement reforms to prevent the misuse of the legal system by litigation funders pursuing unfair windfall profits by:

- Mandating that the class action litigation funding scheme's constitution require the scheme's responsible entity not to be paid any amount in relation to the scheme that is greater than the entity's reasonable costs for managing the scheme (s. 601GA(5)(e));

- Ensuring that the claims distribution method in a funding agreement for a class action litigation funding scheme is fair and reasonable (s. 601LG);

- Introducing a rebuttable resumption that a claim proceeds distribution method is not fair and reasonable if less than 70% of the claim proceeds for the scheme are to be paid or distributed to the scheme's general members as a whole (s. 601LG(5)).

Returns to litigation funders, whether they be based on a settlement sum or an amount awarded by a Court, should be proportionate to the cost and risk undertaken, and should avoid the potential for profits which have been described by various judgments as 'stratospheric', 'arguably excessive' and 'not fair and reasonable'.[4] In his ex-tempore reasons for approving a recent settlement of three class actions regarding the Commonwealth's use of allegedly toxic firefighting foam, Lee J acknowledged the value of the availability of class actions but noted that the phrase 'access to justice' is often misused by finders to justify "what at bottom is a commercial endeavour to make money out of the conduct of litigation".[5]

[4] *Tredrea v KPMG Financial Advisory Services (Australia) Pty Ltd* (No 3) [2019] NSWSC 871, [89], [94]; *Endeavour River Pty Ltd v MG Responsible Entity Limited* [2019] FCA 1719.

[5] Eveleigh, A., '"A significant inequality of arms": Funding led to better outcome in PFAS class action, judge says', *Lawyerly* 9 June 2020.

The financial incentive for litigation funders to take an unfair proportion of settlement proceeds or an award from litigation proceedings fills investors' pockets at the expense of group members. In order to avoid undermining the policy basis for allowing representative proceedings in Australia, the Litigation Funding Bill would implement appropriate limits on the profits which litigation funders could extract from class action proceedings. The proposed reforms would go a long way toward avoiding the misuse of the Court system as an avenue to turn an easy profit or to gamble on speculative litigation.

Addressing conflicts of interest with law firms

The reforms instituted by the Litigation Funding Bill are reasonably complimented by appropriate limits being placed on the interests taken by law firms in litigation funders in relevant proceedings.

The proposed Litigation Funding Regulations would prohibit the legal representatives of a plaintiff in funded proceedings from having or maintaining a material financial interest in the litigation funder of a relevant action by imposing necessary conditions on the holders of an Australian Financial Services License.

There are multiple avenues via which law firms may inappropriately hold a financial interest in the well-being of a litigation funder over that of their own client. This point is illustrated by the recent matter pertaining to alleged professional misconduct against Norman O'Bryan over the claim that he retained an interest in the funder for a class action which bankrolled the proceedings in which he acted as counsel.[6] In that case, a court-appointed contradictor claimed that Mr O'Bryan retained his interest in the funder despite informing the Supreme Court of Victoria that the potential conflict had been resolved.[7] Allegations included that the legal team misled a costs consultant, falsified fee agreements and charged for time spent on other matters.[8]

Law firms should be prevented from holding any financial or commercial interest in a litigation funder supporting representative proceedings involving that firm.

The Litigation Funding Regulations would protect class members from conflicts arising to their detriment in funded proceedings.

[6] Caulfield, C., 'Prominent silk retained interest in Mark Elliott's action funder after wife sold shares', *Lawyerly* (9 June 2020.

[7] Caulfield, C., 'Prominent silk retained interest in Mark Elliott's action funder after wife sold shares', *Lawyerly* (9 June 2020.

[8] Caulfield, C., 'Prominent silk retained interest in Mark Elliott's action funder after wife sold shares', *Lawyerly* (9 June 2020.

ABOUT THE AUSTRALIAN INDUSTRY GROUP

The Australian Industry Group (Ai Group®) is a peak employer organisation representing traditional, innovative and emerging industry sectors. We are a truly national organisation which has been supporting businesses across Australia for nearly 150 years.

Ai Group is genuinely representative of Australian industry. Together with partner organisations we represent the interests of more than 60,000 businesses employing more than 1 million staff. Our members are small and large businesses in sectors including manufacturing, construction, ICT, transport & logistics, engineering, food, labour hire, mining services, the defence industry and civil airlines.

Our vision is for thriving industries and a prosperous community. We offer our membership strong advocacy and an effective voice at all levels of government underpinned by our respected position of policy leadership and political non-partisanship.

With more than 250 staff and networks of relationships that extend beyond borders (domestic and international) we have the resources and the expertise to meet the changing needs of our membership. Our deep experience of industrial relations and workplace law positions Ai Group as Australia's leading industrial advocate.

We listen and we support our members in facing their challenges by remaining at the cutting edge of policy debate and legislative change. We provide solution-driven advice to address business opportunities and risks.

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