SUBMISSION

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Issues arising from

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

1. We are members of the Class Actions Committee of the Law Council of Australia, but are making this submission in a personal capacity to provide our opinion as to certain unintended legal or practical issues that appear to us to arise from the present draft of the *Treasury Laws Amendment (Measures for Consultation) Bill 2021: Litigation funders* (the **Draft Bill**).

2. Our submission is made in circumstances where the consultation period for the Draft Bill was only around one week long (including a holiday long weekend) and is due to end on 6 October 2021. This limited time period has constrained the time available for our consideration of the draft legislation and regulations affected by the Draft Bill.

3. Some of the matters addressed below appear to us to involve policy questions, going to the desirability of reforms along the lines reflected in the Draft Bill. We understand that the Class Actions Committee of the Law Council is considering such matters.

4. We have reviewed:

   (a) an email, dated 30 September 2021, from Treasury, which attached the draft legislation and regulations

   (b) an Exposure Draft of the *Treasury Laws Amendment (Measures for Consultation) Bill 201: Litigation funders* (being the Draft Bill)

   (c) the Explanatory Materials in respect of the Draft Bill

   (d) an Exposure Draft of the *Corporations Amendment (Litigation Funding) Regulations 2021* (the Draft Exposure Regulations) and

(e) an Explanatory Statement in respect of the Draft Exposure Regulations.

5. It is appropriate to observe at the outset that the draft Bill appears to misunderstand or overlook certain important features of "representative" litigation, the chief examples of which are of course "class actions" under Part IVA of the *Federal Court of Australia Act 1976 (Cth)* or cognate regimes in most of the States' Supreme Courts.

6. The most troubling consequence of those misunderstandings or oversights is that the Draft Bill appears to us clearly to have consequences extending beyond the class actions that appear to be the intended target for the legislation.

7. Further, a number of instances of awkward drafting means that the Draft Bill's effectiveness in addressing the perceived problems with existing class action procedures is likely to be limited. At the very least, the ambiguities and complexities that the draft legislation would introduce can confidently be expected to lead to substantial costs and more delays in class actions over the short and medium term.

8. For ease of reference, we propose to address the issues raised by the Draft Bill in the order they appear in the text.

'Claim proceeds'

9. The definition of 'claim proceeds' in draft section 9 is ambiguous. It refers to "total money obtained as remedies", and the accompanying Note records that this means "the total (gross) money obtained … before any reductions for the costs of the proceedings". Three obvious issues arise.

10. First, although this definition works adequately for "all in" settlements, where a single payment is made in respect of damages and legal costs, it is unclear how it operates in the very common situation where there is a settlement or judgment for compensation *plus* a stand-alone settlement term or court order for legal costs.

11. In the latter situation, the stand-alone term or order might or might not fully indemnify the lead plaintiff for the actual costs of the litigation – that is, the term or order might still need to be supplemented by the kind of "reimbursement" order contemplated by s.33ZJ of the *Federal Court of Australia Act* (FCA Act). It is unclear whether the new definition of "claim proceeds":

(a) is intended to treat all costs terms or costs orders as "remedies", or alternatively

(b) preserves the effect of stand-alone agreements or orders for costs, and only addresses any s.33ZJ-type deductions from the amounts otherwise to be distributed to class members as compensation for their claims.

12. Second, if the definition is intended to treat as "remedies" stand-alone settlement terms for costs, or court orders for costs, then it not only negates the parties' freedom to agree upon terms for the settlement of class actions, but also interferes very strangely with courts' discretions. In a low-value settlement of a complex (and therefore costly) class action, a costs order assessed by the court as reflecting a fair and reasonable payment to the class plaintiff would, if the arithmetic of the case so required, instead be diverted toward compensation for the class members. This appears to us to be an extraordinary thing for legislation to do.

13. Third, in a funded class action the funder may pay, or assume liability for, either some or all of the legal costs and disbursements incurred by the applicant(s) in pursuing the litigation. For example, it is not unusual for the funder to only agree to pay a percentage of the costs incurred by the applicant's lawyers, with the shortfall to be recovered by them by way of a costs order, or out of any settlement. The funder only has a commercial interest in the recovery of any costs incurred *by the funder*. The present proposed definition of 'claim proceeds' does not, in our view, distinguish sufficiently between (a) the compensation or damages received, (b) the legal costs borne by the funder and (c) legal costs incurred but not borne by the funder.

'Claims proceeds distribution method'

14. The proposed requirement that the funding arrangements for a class action specify *at the outset* the "method for determining the amount of any claim proceeds … to be paid or distributed" to the class members appears to us to reflect an inadequate appreciation of the practical realities of "mass claim" litigation. The proposed definition is inherently problematic, unworkable (or largely meaningless) in practice, and likely to increase the costs and delays associated with settlements of class actions.

15. In our experience, a substantial proportion of class actions settle upon terms that are imaginative and unique to the circumstances of the particular claim. Personal injury cases for victims of institutional child abuse (such as the *Fairbridge Farm Schools* action

in the Supreme Court of New South Wales[1] or more recently *McAlister v. NSW* in the Federal Court[2]) are one example.

16. Another example comprises consumer claims, for example the recent *VW Diesel Emissions* class actions[3]. Throughout the conduct of the five class actions over several years, vexed issues arose as to whether damages would be recoverable based on:

    (a) the diminution in value of the cars;

    (b) the purchase price paid,

    (c) the purchase price paid, less an allowance for the mileage and period of use of the vehicle;

    (d) the 'scrap' value of the cars; and/or

    (e) an allowance for increased petrol consumption and other maintenance costs arising out of the so-called 'fix' of the vehicles.

17. The proceedings were settled for a lump sum amount without any of these issues being resolved and without knowing how many of the 100,000 owners of affected vehicles would opt in to the settlement within the required time frame. The settlement terms provided for a varying overall settlement payment depending on the number of claims, and subject to an ultimate cap. Thus, even at the date of settlement approval it was not known whether the individual payments would need to be "ratcheted down" in the event that more claimants submitted claims than had been anticipated.

18. The scheme for distribution of the eventual settlement fund *between* the participating claimants ('settlement distribution scheme', that appears to equate to the Draft Bill's concept of a 'claim proceeds distribution method') approved by the Federal Court itself involved a very complex methodology, based on expert evidence and data not available at the inception of the litigation. It adjusted settlement payments to each participating class member according to the type and model of vehicle, the age of the vehicle and the number of timely claimants, etc.

19. This was important consumer-protection litigation, and the merits of the proceeding are amply demonstrated by the quantum of the eventual settlement. It appears to us to be precisely the kind of consumer redress outcome that is sought by the *Australian Consumer Law* and other consumer-protection legislation. But the necessarily complex

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[1] *Giles v Commonwealth of Australia (No.2)* [2014] NSWSC 1531

[2] *McAlister v State of New South Wales (No 3)* [2018] FCA 636

[3] *Cantor v Audi Australia Pty Limited (No 6)* [2020] FCA 658

'*claim proceeds distribution method'* could not on any realistic view have been conceived or incorporated in any funding agreement circulated at the *outset* of the litigation.

20. Finally, it is important to note that even in cases where the losses of individual claimants might be expected to be amenable to a very "formulaic" distribution methodology, cases do arise that require, as a matter of fairness, imaginative and complex distribution schemes. Cartel claims involve "pass through" issues are one example.[4] Even in more "mainstream" shareholder class actions there are cases where the eventual settlement terms were quite different from the simple payment of dollars from A to B – we note the current proposed "share allocation" settlement in the *GetSwift* class action.

21. In short, we are moved to observe that it reflects a poor understanding of the practicalities of class action litigation to suppose that it is viable at the *outset* of a complex proceeding to stipulate, in anything other than very general terms, the likely method for distributing any eventual proceeds among the class members.

22. We do not overlook that draft s.601LG(1)(b) specifically provides that a court can vary a claim proceeds distribution method later in the action. But this process presumably may require an amendment to the Scheme constitution, given that the class action is by definition a managed investment scheme. The process of drawing, obtaining approval for, notifying and dealing with responses to such an amendment seems likely only to prolong the time and enlarge the costs required for the settlement-approval steps in a class action. Those costs will necessarily be visited on group members, either directly in the court's assessment of the proper costs of the litigation and the fair remuneration for the funder, or indirectly in the overall transaction costs of class actions and the average market rates charged by funders.

23. Finally, we note that the draft proposal contemplates that the funder offering terms for a *proposed* class action is to specify the intended claim proceeds distribution method. We do not consider that appropriate or practicable

24. At present, the formulation of a claims proceeds distribution method – as noted, usually called a 'settlement distribution scheme' – is the primary if not exclusive responsibility of the lawyers acting on behalf of the class, acting in the best interests of the class overall to whom they owe fiduciary duties. Its preparation usually occurs in the context of a proposed settlement and includes negotiation with the lawyers for the respondent(s).

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[4] See eg., *Darwalla Milling Co Pty Ltd v F Hoffmann-La Roche Ltd* [2006] FCA 915.

Indeed, the Federal Court has expressed concern at the direct participation of funders in this process.[5] The role of the funder is and should be limited to negotiating the basis on which *it* is to be remunerated.

25. Against that background, we consider that the provisions requiring that a claim proceeds distribution method be stipulated at the outset, and in the funding agreement for the action, are highly inapt. For the other reasons we have identified, we also do not consider that the Draft Bill's proposal is realistically achievable in practice.

26. We note, in conclusion on this point, that the existing practice in class action litigation – invariably enforced by the courts, in requiring that notices be sent to group members at various points during the running of a class action – already require that class members be notified at any early stage of the *kinds* of distribution schemes that are may be adopted in the event of a successful litigation. Moreover, and most importantly, any ultimate scheme is ineffective unless and until it is approved by the relevant court. It appears to us that the Draft Bill fails to appreciate the very searching enquiries that, in our experience, courts always make in considering proposals for the settlement of class actions, or for the methods of distributing claim proceeds among the claimants. Once the nature and extent of the enquiries undertaken by the courts are appreciated, we do think that the concerns that appear to motivate these provisions of the Draft Bill are considerably diminished.

'Class action litigation funding scheme'

27. A 'class action litigation funding scheme' is defined (in draft s 9AAA) by reference to five attributes, all of which are required to be satisfied.

28. We wish to draw the most specific attention to this remarkable provision. It is deeply troubling, because its effect is to extend the reach of the Draft Bill far beyond class actions.

29. That is, its clear effect is to re-characterise, as 'class action litigation funding schemes', any litigation in which non-lawyer third party provides financial assistance or indemnity to a litigant. The awkward drafting here would include an insurer that exercises rights of subrogation to sue in the name of an insured to recover compensation from a third party, as well as any litigation by co-plaintiffs under a costs-sharing arrangement between them. This would also encompass insurers who provide ATE policies in respect of adverse costs as well as philanthropic non-profit entities (such as the Grata Fund) that provide

[5] *Court v Spotless Group Holdings Limited* [2020] FCA 1730 at [43]ff (Murphy J).

limited indemnities in respect of adverse costs orders without any payment or commercial return.

30. Take the recent examples of insurers naming groups of their insureds as co-plaintiffs in actions against third-party wrongdoers, in particular in bushfire cases. In each of the Parkerville Bushfire litigation in the Supreme Court of Western Australia,[6] the Garvoc and Terang bushfire cases in the Supreme Court of Victoria, the Forcett/Dunalley Bushfire case in the Supreme Court of Tasmania,[7] and the current Tathra Bushfire litigation in the Supreme Court of New South Wales, all five elements of the draft s.9AAA definition of 'class action litigation funding scheme' would have been satisfied.

31. Likewise, it seems clear that the proposed definition would catch:

    (a) any subrogation action by an insurer, even if for only one of the "one or more persons" described in draft s.9AAA(a);

    (b) any provision of financial assistance to even "one" litigant, by a person other than the lawyer actually running their case; and

    (c) a cost-sharing arrangement between co-plaintiffs.

32. These extraordinary consequences are the likely result of the s.9AAA definition. We do not understand them to be an intended consequence of the Draft Bill, and the potential for this awkwardly drafted s.9AAA definition to create very significant disruption to litigation even outside the class action jurisdiction is very concerning.

33. In the course of preparing this advice we have noted that the problems just identified in fact appear to have been introduced to the Corporations Act by the removal, during 2020, of the former exemption that had operated to exclude litigation funding schemes from the "managed investment scheme" provisions. With that removal, the existing complications are compounded by the proposed changes that appear to make regulations in respect of commercially funded class actions applicable to the non-class action situations that we have identified above.

34. Accordingly, quite separately from the need to adjust the present draft to avoid the effects noted above, the Draft Bill ought to also amend the existing law to make clear – or clearer – precisely what kinds of "assisted" litigation are intended to be caught by the "MIS" provisions.

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[6] *Herridge v. Electricity Networks Corporation* [2019] WASC 94; *Herridge v. Electricity Networks Corporation* [2021] WASCA 111.

[7] *Prestage v. Barrett* [2021] TASSC 27.

35. Finally in this regard, we note that draft s 9AAA provides (in par. (b)) that the features of a 'class action litigation funding scheme' include that the possible entitlement of each of the claimants to remedies relates to transactions or circumstances that occurred before *or after* the *firs*t funding agreement (dealing with *any* issue of interests in the scheme) is finalised.

36. We have some difficulty comprehending how this would operate in practice. In particular, we struggle to see how a person whose claim has not *yet* arisen could be included in the managed investment scheme.

Prohibition or inhibition of "open" class actions

37. Draft s 601GA(5) provides that the 'scheme's constitution' must provide that, to be a general member of the scheme, claimants are required to *agree in writing* to be a member of the scheme and to be bound by the scheme's constitution.

38. When it is also borne in mind that:

    (a) the underlying class action is a managed investment scheme; and

    (b) there is at least a real question as to whether a managed investment scheme can extend to the "investments" of persons who are not members of *the scheme*

    it appears to us to follow that a class action (managed investment scheme) cannot now be conducted on behalf of persons who are not members of the scheme ('general members' for the purposes of this draft Bill). At the very least, proposed s.601GA(5) creates a strong incentive for class action plaintiffs, their lawyers and funders to avoid the question and simplify the difficulties by confining the actions to "closed" classes comprised only of the persons who have executed the applicable funding agreement.

39. This appears to us to be contrary to the statutory open or 'opt out' class regimes, and inconsistent with one of the stated objectives for Part IVA of the *Federal Court of Australia Act* and its cognates in the state courts, namely reducing multiplicity of proceedings. That objective has very frequently been noted by the courts managing class actions, and indeed the encouragement of "open" class actions was one factor leading the Federal Court (and subsequently other courts) to endorse not merely funding equalisation orders but also common fund orders.

40. The effect of s.601GA(5) seems to us very likely to be a rapid abandonment of open class actions and a reversion to closed actions. There are four likely sequalae:

(a) First, persons who do not happen to learn about a potential class action, or who learn about it but are hesitant to join, are even less likely to get information about the action as it progresses, and consequently less likely to recover compensation to which they might actually be entitled;

(b) Second, even if non-class members do learn of a funded class action, there is an increased risk that they will bring separate claims rather than join the class action. Those claims might be able to "piggyback" the funded class action, but our experience of the few situations where this has occurred in the past shows that the costs to defendants, in particular, are likely to be materially increased by having to deal with these incidental plaintiffs as well as the main class action plaintiff;

(c) Third, closed class actions increase the risk of competing class actions. The practice in recent years of resolving such competition by staying all but one of the class actions, and permitting the ongoing action to proceed on an open basis, would seem to become unavailable under the proposed s.601GA(5) regime; and

(d) Finally, absent an open class action, defendants can no longer settle the action with the knowledge that they thereby resolve all legacy issues associated with the events giving rise to the claim. They will only be able to settle the claims of the "signed up" class members in that particular action. This is an obvious disincentive to settlement, as defendants would rightly be concerned that publicity around a settlement will only prompt new claimants to come forward. Class actions will be less likely to settle, more likely to require trial time, and more expensive in the long run, in particular for unsuccessful defendants.

Proposed Part 5C.7A – Enforceability of funding agreements

41. Section 601LF is extremely unclear. Subs. (1) provides that a funding agreement for a relevant class action is not enforceable "unless" one of subs. (2)-(4) applies. Each of subs. (2)-(4) then includes as an element the condition that the relevant Court "does not make" an order of the kind then defined as a "common fund order".

42. We offer one minor and one major observation regarding this provision.

43. The minor observation is that the definition of "common fund order" would also catch the quite different kind of order usually described as a "funding equalisation order".[8] The

[8] In very simple terms, a funding equalisation term in a settlement distribution scheme, or a funding equalisation order made in combination with a settlement distribution scheme, deducts from an overall settlement the *quantum* of funding costs that "funded" class members agreed to pay, and distributes the balance pro rata among funded and unfunded group members so that they all enjoy the same "net" rate of recovery. The funder still only recovers the

former was disallowed in some circumstances in *Brewster* while the latter were endorsed.[9] It is not clear whether the reference to "common fund order" in the draft Bill is intended to catch funding equalisation orders.

44. Our more major observation is that s.601LF appears to preserve the existing, post-*Brewster* practice of class action plaintiffs commencing a proceeding without a "book" of signed-up, funded class members, but giving notice to all class members that the plaintiff (or its funder) proposes to seek a common fund order in the event of a successful settlement or judgment in the proceeding, and then seeking (and sometimes obtaining) the common fund order at the conclusion of the proceeding.

45. As we read s.601LF (2), for example, a plaintiff who runs a successful class action in the hope of a common fund order, and who ultimately obtains the common fund order, would avoid the operation of s.601LF(2) (or sub.(3) or (4) if the proceeding were in a State court), with the consequence that s.601LF (1) does not attach. We assume that the plaintiff's funding agreement would therefore remain enforceable regardless of whether it complied with s.601GA (5). It would seem to follow as well that s.601LF necessarily implies that the relevant court would have remained free to make a common fund order (as defined), and that such an order, if made, would then override the terms of any scheme for the class action.

46. We assume that this is the intended consequence of s.601LF, namely to preserve the ability of class action plaintiffs to commence at least closed class actions in the hope of eventually replacing the scheme terms as to 'claim proceeds distribution method' with a common fund order. We have given thought to the question whether this intended effect could be made clearer but on balance, having noted the issue, it appears to us that the effect is clear. In particular, we take s.601LG(1)(b) and (7) to make clear that the effect of a common fund order, if made, is to vary the terms of the anterior scheme for the class action. This must be correct.

47. There is, however, another complication. *Common fund* order is defined in draft s 601LF(2)(c) (which presumably also applies to ss (3) and (4)) as one made for the *purposes* of:

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remuneration due to it under the funding contracts it entered with the funded class members. In contrast, a common fund order deducts from an overall settlement the *rate* of funding costs that "funded" class members agreed to pay – in effect, treating unfunded group members as if they too entered the relevant funding agreement. The effect is to increase the remuneration recovered by the funder, above the amount to which it was entitled under the contracts it actually made.

[9] *BMW Australia Ltd v Brewster; Westpac Banking Corporation v Lenthall* [2019] HCA 45.

(a) fixing the remuneration of the funder as a portion of the total money obtained as remedies *and*

(b) requiring one or more persons who obtain such a remedy, but who are *not* general members of the scheme, to contribute to the funder's remuneration.

48. Given that a class action litigation funding scheme is proposed to be legislatively confined to 'general members', it is not clear to us how a court could make an order, in respect of such a scheme, that persons who are not in the scheme must contribute to the funder's remuneration.

49. It may be that this could arise where separate class actions (only one being a class action litigation funding scheme) are commenced and are resolved concurrently through an award of damages or a settlement encompassing all claimants in each of the class actions. Other than in this sort of scenario we have difficulty comprehending how the proposed 'common fund' provisions are intended to operate.

Application to State courts not exercising federal jurisdiction – s.601LF(4)

50. This *may* give rise to constitutional difficulties insofar as this significantly impairs, curtails or weakens the capacity of states or state courts to exercise their constitutional powers or functions: see for example *Melbourne Corporation v Commonwealth* (1947) 74 CLR 31.

51. In view of the limited time constraints allowed for the consultation process we have not had an opportunity to consider this issue in detail.

'Fair and reasonable' test – s.601LG(3)

52. We do not consider it appropriate that the word 'only' be retained in s.601LG(3). The factors listed in the subsection are amongst the factors already considered by courts in assessing the fairness and reasonableness of funders' remuneration but:

(a) since the definition of 'claim proceeds distribution method' would seem to embrace arrangements for sharing legal costs as well as funder's remuneration, the s.601LG(3) list is more limited than the factors already being taken into account by courts in assessing the fairness and reasonableness of legal costs; and

(b) whether as to legal costs or funder's remuneration, we consider it undesirable to confine the factors to which a court might have regard.

53. The deletion of the word ‘only’ in the prefatory words to s.601LG(3) would mean that the provision still operates to identify important factors to which a court is required to have regard, without excluding the possibility of unusual additional circumstances that on any sensible view ought reasonably to be taken into account. Obvious considerations in this regard include:

    (a) the merits of the claim and defence,

    (b) the solvency of the respondent or

    (c) limits on insurance cover available to a respondent in answer to a successful claim.

54. We wish to record a particular concern over s.601LG(4), however. We do not consider it appropriate that such an important matter be left to regulations, rather than subjected to the scrutiny required from Parliament for the passage of legislation.

Other matters

55. We have focused on the Draft Bill but note that in a number of important respects the Explanatory Materials do not accurately describe the manner in which the provisions would operate, if enacted.

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