Treasury Laws Amendment (Measures for Consultation) Bill 2020
Litigation funders

Submission of the US Chamber of Commerce
Institute for Legal Reform

October 5, 2021

Thank you for the opportunity to respond to the Exposure Draft of the Treasury Laws Amendment (Measures for Consultation) Bill 2021: Litigation funders (**Bill**).

The US Chamber Institute for Legal Reform (**ILR**) is a not-for-profit public advocacy organisation affiliated with the U.S. Chamber of Commerce, which is the world's largest business federation. It represents the interests of more than three million businesses of all sizes and sectors, as well as state and local chambers, and industry associations. ILR's mission is to ensure a simple, efficient and fair legal system.

Since ILR's founding in 1998, it has worked diligently to limit the incidence of litigation abuse in the U.S. courts and has been actively involved in legal reform efforts in the U.S. and abroad. Its members have a direct interest in how litigation is conducted in Australia as many carry on business in Australia or trade with Australians.

For the reasons set out below, the ILR supports the proposed reforms in the terms set out in the Bill.

The ILR urges the Government to enact the Bill as soon as possible.

Introduction

Class actions are an established part of the Australian legal landscape. They allow groups of people affected by a common set of facts or circumstances to collectively pursue compensation. In appropriate cases, class actions provide efficient access to justice.

Litigation funding, particularly of class actions, has also become entrenched in the Australian legal system. While the provision of funding can assist claimants

pursue proceedings they might otherwise be unable to afford, the emergence of the litigation funding industry has come at a high cost to both consumers and the Australian economy.

Litigation funders, many of which are foreign entities operating off shore, and the enormous fees taken by funders and plaintiffs' lawyers have driven an explosion in the number of class actions in Australia.

Every year, the number of class actions commenced in Australia increases – as evidenced by the most recent study published by leading global law firm, King & Wood Mallesons.[1]

The year to 30 June 2021 saw another record set in terms of the number of class actions filed in Australia with at least 63 class actions commenced. Compare this to, say, the year ended 30 June 2013 when just 18 class actions were commenced.

While supporters of the class action industry argue that the absolute numbers are low compared to, say, the United States, this ignores the enormous size of many of these actions and the impact they have on Australian businesses and the broader economy.

To the year ended 30 June 2021, the Australian class action industry has pulled at least $2,315 million from the Australian economy. The expression 'at least' is used because this figure is based on information that has been published and excludes so called 'confidential' settlements or other decisions where the actual figures have been suppressed.

As the number of class actions has steadily increased, the returns to class members have fallen. This is because the benefits of these class actions are being diverted away from the class members to the litigation funders and plaintiffs' lawyers.

Unconscionable fees and commissions have seen the Australian class action system move from providing access to justice to delivering extraordinary returns to investors and lawyers. This is grossly unfair to consumers and must be reversed.

Significantly, it is not just the business community or class members themselves who are making this point.

[1] *The Review – Class Actions in Australia 2020.2021, October 2021*

In its submission to the Victorian Law Reform Commission inquiry, the National Union of Workers relevantly stated that:

> *"The legal system is rigged against us…"*

when describing a class action outcome which saw the entirety of an award of over $5 million taken by the plaintiffs' lawyers, litigation funders, and others with absolutely nothing going to the class members despite a successful outcome![2]

While this is obviously an extreme example, the returns to class members, particularly when compared to the amounts taken up by litigation funders in commissions, fees, and other charges, is a real concern – particularly when compared with matters not involving a litigation funder.

Data from the Australian Law Reform Commission's review into class actions determined that the median return to group members in funded matters was just 51% of the settlement award, compared to 85% in unfunded proceedings.

Take, for example, three class actions considered by the Australian Law Reform Commission in its report:

- *Clarke v Sandhurst Trustees Limited (No 2)*[3]*:* A settlement of $16.85 million with $5 million (30%) taken by the plaintiffs' lawyers and another $5.06million (30%) taken by the litigation funder leaving just 40% for class members.
- *Money Max Int Pty Ltd v QBE Insurance Group Ltd*[4]: A settlement of $132.5 million settlement with $21.8 million (16.5%) taken by the plaintiffs' lawyers and $30.75 million (23.2%) taken by the litigation funder leaving 60.3% for class members.
- *Caason Investments Pty Limited v Cao (No 2)*[5]: A settlement of $19.25 millionwith 43% for legal costs, 30% taken by the litigation funder (using a common fund order which meant that class members were probably not even aware of what was being deducted let alone given an opportunity to object!) leaving a mere 27% for class members.

The fees and charges being taken by litigation funders are delivering extraordinary returns on their investments.

Consider what the litigation funders themselves are prepared to admit -

[2] Submission 16 to the inquiry National Union of Workers_25-09-17.pdf The Huon Corporation proceedings
[3] [2018] FCA 511
[4] [2018] FCA 1030
[5] [2018] FCA 527

the 'internal rate of return' for one confidential litigation funding investment by Omni Bridgeway was an eye watering 2,657%.[6]

In large part, this has come about because the litigation funding industry, a significant component of the Australian financial services industry, is essentially unregulated.

A series of inquiries and reports, the most recent conducted in 2020 by the Parliamentary Joint Committee on Corporations and Financial Services, have recommended the regulation of the litigation funding industry. While temporary measures were introduced in 2020, establishing comprehensive substantive arrangements is essential to properly protect both consumers and the Australian economy.

For these reasons, the Bill is a welcome reform.

It will, for the first time, ensure a minimum return to class members.

It will also go some way to ensuring that class members, often some of the most vulnerable members of the Australian community, are protected from the excesses of the litigation funding industry.

Class members must consent to participation

While the Australian class action system was intended to operate as an 'opt out' system the introduction of third-party litigation funding saw this model being challenged by the funders. It simply didn't suit their business model and gave rise to the so called 'free riders' – class members who had not entered into a litigation funding agreement. In response, the funders convinced the courts to allow them to conduct closed, what are effectively 'opt in', class actions.

While this effectively reversed the original intent of the class action regime, it had the benefit of ensuring that only class members who had agreed to participate in the funding arrangements, and thus contribute to the funders remuneration, were charged those fees.

The introduction of the common fund order (**CFO**) saw the funder's business model move back to 'opt out' or open class actions. In other words, the class comprises everyone who falls within the class description, as defined by the promoter of the class action, regardless of whether individual class members even know about the class action, let alone have consented or agreed to participate.

When the court made a CFO it enabled the funder to take a percentage of **every** class member's compensation despite not having their agreement or consent. While this was portrayed as an answer to the so-called free rider problem it was

[6] [Omni Bridgeway Annual Report 2020] page 30

both inherently unfair and ensured that the litigation funders and their lawyers were guaranteed truly enormous returns on their investment.

Not surprisingly CFOs were challenged on appeal and ultimately found to be beyond the scope of the legislation. However, neither the litigation funders nor some judges were prepared to let the matter rest and there have subsequently been several attempts to revive the CFO.

This Bill will end this debate and ensure that litigation funders and plaintiffs' lawyers can only take fees, charges and commissions from those class members who actually know about the arrangement and have agreed to enter into the transaction.

Ensuring a seventy percent return to class members

The mechanism proposed to ensure a minimum return to class members strikes an appropriate balance between imposing a hard cap and simply leaving the decision on the funder's return on investment to vague principles applied from case to case.

By adopting this proposal, the Parliament will be making it clear to the courts that a return of **at least** 70 percent of class members compensation is the norm. At the same time, it leaves open to the court the option of varying that amount in special or unusual circumstances.

The litigation funders and plaintiffs' lawyers have criticised this provision on the basis that it will make class actions uneconomic to fund.

However, given the return on investment that is being generated by funders and the relatively low level of risk they take, this argument is simply unsustainable. In this context it should be noted that no litigation funder has ever provided any financial or economic analysis to support the contention that a 70% guaranteed return to class members would, in fact, render class actions uneconomic.

On the other hand, plaintiffs' lawyers arguing for the introduction of a contingency fee regime have stated that a return of 75% of the total compensation to class members was an appropriate figure after allowing for legal costs, the cost of funding the action and an appropriate premium for risk.[7]

Given that a payment to the plaintiffs' lawyers of 25% of the total compensation would return a far greater profit to the lawyers than if they ran the case on a traditional 'no win no fee' basis, the suggestion that 30% is uneconomic is clearly untenable.

It should also be noted that plaintiffs' lawyers like Slater & Gordon or Maurice

[7] See the comments and submissions made by Maurice Blackburn and Slater & Gordon in the context of the Victorian group costs order debate.

Blackburn have had no difficulty in successfully running class actions on a 'no win no fee' basis.

A more serious question has been raised by some in the business community who have expressed concern that a 30% return to the litigation funders and plaintiffs' lawyers will become the floor and that the courts will only ever increase that return.

This concern might have had some substance but for the provisions of the Bill setting out the factors that must be considered by the court in determining whether a funding arrangement is fair and reasonable.

Assessing whether a funding arrangement is 'fair and reasonable'

In assessing whether a funding arrangement is fair and reasonable, the court must consider and take into account a number of factors including –

1. In relation to the proceedings itself:
    a. the amount, or expected amount, of claim proceeds;
    b. the legal costs of the proceedings incurred by the funder and the extent to which those legal costs are reasonable;
    c. whether the proceedings have been managed in the best interests of the class members to minimise the legal costs for the proceedings; and
    d. the complexity and duration of the proceedings;
2. The comparative profit of the litigation funder compared with the actual costs incurred by the funder in funding the proceeding – i.e. the funder's investment.
3. The risks accepted by the parties to the agreement by becoming parties to the agreement; and
4. The sophistication and level of bargaining power of the class members in negotiating the agreement.

This analysis will ensure, for the first time, that the appropriate economic and commercial factors driving what is a purely commercial arrangement are assessed by the court in determining what is a fair and reasonable arrangement.

Assessment not left to the court and the parties

Past decisions of the courts when assessing the fairness or otherwise of funding arrangements have relied almost entirely on the submissions of the parties.

The judges making these decisions do not have the training, experience or in, most cases sufficient information, to properly assess the return to a funder let alone the fairness of that return on a risk adjusted basis. They have no staff who can independently consider these issues.

The parties to the proceedings who make submissions in relation to these issues are hopelessly conflicted.

From the plaintiffs' perspective -

- The lawyers appearing for the class members are effectively being remunerated by the funder and will often be involved in a series of other or future funding arrangements with the same funder.
- The funder is almost always instructing the class members' lawyers in relation to an application which will determine the level of the funders remuneration.
- The funders expressly deny any fiduciary obligations to those whom they fund.
- Evidence about the reasonableness of the costs that have been incurred in the proceedings will usually come from a costs assessor instructed and remunerated by the funder and the team whose costs the assessor is meant to be assessing.

From the defendants' perspective –

- The proceedings have usually been settled or otherwise resolved and the defendant has no interest in unnecessarily prolonging the proceedings nor challenging the reasonableness of what is a key issue in any settlement – the funders remuneration and the fees of plaintiffs' lawyers.
- The defendants have no insight or information in relation to the costs that have been incurred by the funder and its lawyers, let alone the return in investment.
- In many cases the evidence provided by the funder and plaintiffs' lawyers is treated as 'confidential' and kept from the defendant and its lawyers.

The actual class members – who should be the focus of the proceedings – have no access to the relevant information about the fees charged by their 'own'

lawyers and the funder, let alone any independent representation.

Worse still, where there has been fraud involved, the mechanisms designed to protect the class members have completely failed.

Consider what occurred in the *Banksia* proceedings where one of Australia's most senior and experienced class action jurists was oblivious to the fraud that was occurring in the proceedings he was supervising.

The Bill effectively addresses these significant weaknesses. It requires the court in most cases to also consider –

1. A report from an independent fee assessor who will assist the court in determining if the proposed method is fair and reasonable; and
2. The submissions of a 'contradictor' representing the interests of the class members.

These provisions are critical to the success of the reforms proposed in the Bill.

While costs assessors appointed by funders and their lawyers in the past have been next to useless, contradictors have been devastatingly effective in protecting the interests of the class members – consider again *Banksia* and the first application for a contingency fee arrangement in the Supreme Court of Victoria.

Appropriately, the litigation funder must bear the costs of the assessor and contradictor.

Other provisions

The ILR welcomes the new provisions in the Bill that clearly define a litigation funding arrangement as a Managed Investment Scheme (MIS).

The unfortunate history of decisions by the courts following *Brookfield*[8] in 2009, and the 2011 decision by the then Federal Government to effectively deregulate litigation funding significantly weakened the position class members.

The inclusion of a clear definition will remove any lingering doubt and entrench an effective regulatory regime.

This will be further strengthened by the requirement for:

- The responsible entity operating the MIS to be a public company that holds an Australian Financial Services License (AFSL).
- The funding agreement to expressly provide that it is subject to the law of

[8] *Brookfield Multiplex Ltd v International Litigation Funding Partners Pte Ltd* (2009) 180 FCR 11

an Australian jurisdiction and that disputes in relation to the agreement must be heard in an Australian Court**.**

- The responsible entity be limited to the reimbursement of its reasonable costs in operating the MIS.

These provisions will ensure that litigation funding arrangements are governed by a robust, Australian, regulatory regime that can be enforced by the Australian courts.

Will the proposed reforms have an adverse effect on access to justice?

Litigation funders and plaintiffs' released statements critical of the Bill and the reform proposals immediately upon its release. This was to be expected.

The Bill represents the first real challenge to a business model that has allowed the funders and their lawyers to extract enormous rewards from their 'clients' with little or no scrutiny let alone challenge.

For the first time, the Bill will establish a framework for the effective scrutiny of litigation funding agreements and the conduct of those who seek to benefit from the arrangements.

While the litigation funding industry, the corporatised plaintiffs' legal firms, and their well-funded lobbyists have claimed that these reforms will severely affect, if not bring an end to, access to justice, there is simply no evidence to support that assertion.

Indeed, the contrary is true.

The same claims were made when the Government introduced a requirement for litigation funders to hold an AFSL and for litigation funding to be treated as a Managed Investment Scheme.

The litigation funders and large plaintiffs' law firms argued that those modest reforms would mean class actions would disappear from the Australian legal landscape and that the 'victims' of corporate and government wrong doing would be denied the opportunity for justice.

However, the facts simply don't support these propositions.

As noted earlier in this submission, independent analysis has confirmed that, rather than seeing a fall in class action filings the number has actually increased.

In 2020/21 a new record for the number of class actions filed in Australia was set.

Rather, by enacting these reforms, Parliament will ensure that class members actually receive justice in the form of proper compensation rather than just what is left after the litigation funders and plaintiffs' lawyers have taken the lion's share.

Conclusion

The proposals set out in the Bill represent a further important step in regulating the litigation funding industry.

The reforms will protect consumers by striking an appropriate balance between their interests, the ligation funding industry and the Australian economy.

We urge the Australian Government to enact the Bill as soon as possible.

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M. Scévole de Cazotte
Senior Vice President - International Initiatives
U.S. Chamber Institute for Legal Reform
+1 202 251 1050 | sdecazotte@uschamber.com