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Manager
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via email: MCDLitigationFunding@treasury.gov.au

Dear Treasury

**Guaranteeing a minimum return of class action proceeds to class members**

Thank you for the opportunity to comment on Treasury's consultation paper: *Guaranteeing a minimum return of class action proceeds to class members* (**Consultation Paper**).

The Australian Institute of Company Directors' (**AICD**) mission is to be the independent and trusted voice of governance, building the capability of a community of leaders for the benefit of society. The AICD's membership of more than 45,000 reflects the diversity of Australia's director community, drawn from directors and leaders of not-for-profits, large and small businesses, and the government sector.

We note that the Consultation Paper draws on the final report of the Parliamentary Joint Committee on Corporations and Financial Services' Inquiry (**PJC**) into Litigation Funding and the Regulation of the Class Actions Industry (**PJC Report**) which raised significant issues about Australia's litigation funding regime.

## 1. Executive Summary

The AICD acknowledges that litigation funding can provide the capital needed to fund litigation and help facilitate access to justice for class members. It is appropriate, however, that regulatory settings ensure that returns to class members are fair and equitable. In summary:

- The AICD supports, in principle, a guaranteed minimum return of gross proceeds of a class action to class members. While we do not have a fixed view on the level of minimum return, we consider that the majority of judgment or settlement proceeds should be returned to class members. We consider this might be best achieved via a Court-overseen graduated approach;

- The AICD supports proposals to enhance the powers of the Federal Court of Australia, including a requirement for the Court to approve a litigation funding agreement in order for it to be enforceable, and a power to reject, vary or amend the terms of any litigation funding agreement if it considers the funding fee is not fair or reasonable; and

- The AICD encourages the Government to consider further reform recommendations put forward in the final report of the Australian Law Reform Commission's (**ALRC**) Inquiry into Class Action Proceedings and Third-Party Litigation Funders and the PJC Report on related issues such as legal costs, conflicts of interest and alternative methods of redress to ensure that class actions operate as efficiently and fairly as possible.

## 2. Reasonable, proportionate and fair returns for class action members.

The AICD acknowledges the important role that class actions play in providing access to justice, and the support that litigation funders provide in facilitating class actions.

However, the AICD has long held concerns about the regulatory settings and commercial incentives driving Australia's attractiveness for securities class actions specifically. Commercial litigation funders play a key role in instigating, funding and directing securities class actions.

The AICD has participated in both the ALRC's Inquiry in 2018 and the PJC's Inquiry into Litigation Funding and the Regulation of the Class Actions Industry in 2020. The AICD's concerns about the increase in securities class actions leading to adverse outcomes have been outlined in submissions to these inquiries.[1]

The AICD welcomed Government regulation of litigation funders under the *Corporations Act 2001* (Cth) (**Corporations Act**) and considers licensing of litigation funders with ASIC oversight an important reform.

As noted by the ALRC, the litigation funding market in Australia is forecast to grow at an annualised 7.8 per cent over the five years through to 2022–2023.[2] The PJC Report noted the scale of growth in litigation funding, participation of international litigation funders in Australia and "the frequency of windfall gains" as drivers for reassessing whether representative plaintiffs, class members and defendants are achieving reasonable, proportionate and fair outcomes[3].

The PJC found that the practice of percentage-based billing "enables windfall profits to be obtained" by litigation funders and is "often disproportionate to the costs incurred and risk undertaken" by funders, with the costs borne by class members via significantly reduced returns.[4] The PJC cited analysis by the ALRC showing that when litigation funders were involved in a class action, the median return to plaintiffs was 51 per cent, compared to 85 per cent when a funder was not involved.[5]

The AICD notes the reportedly high percentage of judgement and settlement proceeds flowing to litigation funders and plaintiff lawyers in securities class actions. We support consideration of targeted measures to promote proportionate litigation funding arrangements and equitable returns to class members.

### a) Design of a guaranteed floor for returns to class members

The AICD supports, in principle, a guaranteed statutory minimum return of gross proceeds of a class action to class members. We do not have a fixed view on the precise floor for any statutory minimum return, as we consider there could be a range of outcomes depending on the risk, complexity, length and size of the claim. However, as a general principle, it is our view that the majority of judgment or settlement proceeds should be received by class members.

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[1] See AICD submission to Parliamentary Joint Committee on Corporations and Financial Services, Litigation funding and the regulation of the class action industry (11 June 2020), available here; AICD submission to the ALRC Inquiry into Class Action Proceedings and Third-Party Litigation Funders (30 July 2018), available here.

2 Justice Sarah Derrington (ALRC), Litigation Funding: Access and Ethics, Australian Academy of Law Lecture (October 2018): https://www.fedcourt.gov.au/digital-law-library/judges-speeches/justice-s-derrington/s-derrington-j-20181004

[3] Parliamentary Joint Committee on Corporations and Financial Services, Litigation funding and the regulation of the class action industry, p. xv.

[4] Ibid, p. 204.

[5] ALRC report Integrity, Fairness and Efficiency – An Inquiry into Class Action Proceedings and Third-Party Litigation Funders (December 2018).

The AICD also recognises the legitimate business model of commercial litigation funders, who should be able to pursue a financial return that is reasonable and proportionate to the risk they undertake.

We are concerned that in different circumstances, a fixed minimum return percentage could operate unfairly to either class members or litigation funders. For example, even a 20 or 30 per cent return of gross proceeds to litigation funders carries with it the risk of windfall profits for higher value claims. In such a scenario, say where $200m in compensation was provided to claimants, a funder could receive up to $40-60m in returns having only outlaid $6-7m in legal and associated costs. Conversely, for smaller claims, it is possible that a large proportion of the proceeds of litigation could be consumed by legal fees.

A graduated approach, where the minimum percentage to class members progressively increases as the amount recovered increases, may be a sensible mechanism to address these complexities.

In the AICD's view, however, a 50 per cent of gross proceeds back-stop should be established to ensure that in no circumstances will claimants receive less than that amount.

Any approach will need to reduce incentives for windfall profits while allowing a fair return for funders and lawyers, taking into account factors such as the risk borne in taking the claim and the type of action, complexity and length of proceedings. This will require detailed and subjective analysis which, in our view, would be best undertaken via the oversight of the Court (discussed below).

**b) Enhanced powers of the Court**

As the Consultation Paper notes, any mechanism which guarantees a minimum rate of return for class members will necessarily interplay with the Courts' existing supervisory role in proceedings.

Accordingly, the AICD supports both the ALRC's Recommendation 14, and PJC's Recommendation 11, to enhance the powers of the Federal Court of Australia. In particular, that the *Federal Court of Australia Act 1976* (Cth) (**Federal Court Act**) be amended to introduce:

- a requirement for the Federal Court to approve a litigation funding agreement in order for it to be enforceable; and
- a power for the Federal Court to reject, vary or amend the terms of any litigation funding agreement when the interests of justice require.

***Federal Court to approve litigation funding agreements***

The Class Action Practice Note (GPN-CA) of the Federal Court of Australia currently provides that the Court has a supervisory and a protective role in class action proceedings. [6] Plaintiff solicitors and third-party litigation funders must disclose their costs and funding agreements to the Court prior to the first case management hearing of any representative proceeding. The Court does not, however, deal with the terms of those agreements until an application for settlement has been filed[7] - in other words, at the conclusion of proceedings when commercial agreements have already been struck.

As noted by the ALRC, whether the Federal Court has the power to vary or set agreements at that time (such as through the use of a common fund order), or whether the power of the Court under s 33V is limited to approving or rejecting the settlement agreement, is unsettled. There are differing judicial

[6] Federal Court of Australia, Class Actions Practice Note (GPN-CA) (2016) cl 6.1, 6.4.
[7] Federal Court of Australia Act 1976 (Cth) ss 33V, 33ZF; Federal Court of Australia, Class Actions Practice Note (GPN-CA) (2016) cl 13. But see Perera v GetSwift Ltd, [2018] FCA 732.

opinions as to whether section 33V provides a statutory basis to depart from an agreed funding commission after the 'bargain is struck' between class members and the litigation funder.[8]

Accordingly, the AICD supports the PJC's recommendation that litigation funding agreements and legal costs require Court approval in order to be enforceable, and that this should be done at the 'early case management hearing' prior to the first case management conference, as recommended by the ALRC.[9]

The exercise of such a power would require the Court to assess legal costs and litigation funding agreements to consider if they are reasonable and accessible to class members. As part of this exercise, the Court could have regard to not only whether the minimum guaranteed return to class members is proportionate relative to proposed funding commissions and legal costs, but also (as noted by the ALRC) the degree of control sought by the funder, how class members were approached to enter into the agreement with the funder, and the funder's ability to unilaterally instruct a different plaintiff law firm.[10]

It is our understanding that upfront approval of the terms of litigation funding agreements would not limit the Court's ability to assess the proportionality and reasonableness of commissions at the time of settlement approval.

***Federal Court power to reject, vary or amend terms of litigation funding agreements***

As part of this upfront approval process and as recommended by the ALRC[11], the Federal Court power to approve litigation funding agreements should be coupled with the power to exercise an express discretion to reject, vary or amend the terms of the funding agreement that the Court considers is not fair or reasonable (while ensuring that no less than 50c in the dollar goes to class members). This would provide class members with meaningful protection prior to commencement of proceedings, when they are arguably most vulnerable to information asymmetry relative to the litigation funder and have a limited or non-existent ability to negotiate the funding fee.

***Exclusive jurisdiction for the Federal Court***

In addition, we support the ALRC's recommendation 7, and the PJC's Recommendation 30, that exclusive jurisdiction be conferred on the Federal Court with respect to civil matters commenced as class actions under the Corporations Act and *Australian Securities and Investments Commission Act 2001*. As noted by the PJC, doing so would ensure procedural efficiency and consistency in the Federal Court's oversight of the fees, operation and conduct of litigation funders. Placing exclusive jurisdiction with the Federal Court would also eliminate competing claims in different jurisdictions as well as address the risk of forum shopping. We encourage the Government to move swiftly to implement this PJC recommendation.

[8] ALRC report Integrity, Fairness and Efficiency – An Inquiry into Class Action Proceedings and Third-Party Litigation Funders (December 2018), p.169-170; Parliamentary Joint Committee on Corporations and Financial Services, Litigation funding and the regulation of the class action industry, p. 152; *Earglow Pty Ltd v Newcrest Mining Limited* [2006] FCA 1433; *Blairgowrie Trading Ltd v Allco Finance Group Ltd (Receivers & Managers Appointed) (In liq) (No 3)* [2017] FCA 330; *Mitic v OZ Minerals Limited (No 2)* [2017] FCA 409; *Liverpool City Council v McGraw-Hill Financial Inc* [2018] FCA 1289.
[9] ALRC report Integrity, Fairness and Efficiency – An Inquiry into Class Action Proceedings and Third-Party Litigation Funders (December 2018), p.115.
[10] Ibid, p. 170.
[11] Ibid, p.176.

## 3. Legal costs in class actions

The AICD also encourages the Government to consider the related issues of the quantum of legal costs and conflicts of interest in the context of litigation funded class actions.

For example, the PJC found that charging an uplift fee, of up to 25 per cent, on the entirety of class action legal costs, when lawyers are receiving payment at regular intervals from a litigation funder throughout the proceedings, is neither reasonable nor proportionate to the level of risk assumed. [12] Commercial incentives also create risks of potential conflicts of interest. As noted by the ALRC:[13]

> *It is argued that the possibility of a large payout will only augment existing conflicts of interest, magnifying the likelihood of solicitors recommending that representative plaintiffs accept offers to settle for the commercial purposes of the solicitor/firm, rather than for the benefit of the client/s.*

The AICD also supports the ALRC's Recommendation 17 that limitations should apply to the use of contingency fee arrangements, including that any action that is funded through a contingency fee agreement cannot also be directly funded by a litigation funder or another funding entity which is also charging on a contingent basis.[14]

## 4. Facilitating a broader range of redress options

The AICD acknowledges the views of litigation funders that legislating a minimum guaranteed return for class members (or otherwise a statutory cap on funders returns) may impact the financial viability of instigating some potential class actions, based on the target rate of return that funders may apply.

The AICD supports consideration of an alternative to class actions in the form of collective redress mechanisms for groups of persons who have suffered loss. We encourage consideration of the ALRC's suggestion that a federal collective redress scheme may have merit.[15] While complex, such a mechanism has the potential to facilitate access to justice more efficiently and equitably.

## 5. Next steps

We hope our submission will be of assistance to Treasury's consultation. If you would like to discuss any aspects further, please contact Christian Gergis, Head of Policy, at cgergis@aicd.com.au or Laura Bacon, Policy Adviser, at lbacon@aicd.com.au.

Yours sincerely,

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[12] Parliamentary Joint Committee on Corporations and Financial Services, Litigation funding and the regulation of the class action industry, p. 252, Recommendation 22.
[13] ALRC report Integrity, Fairness and Efficiency – An Inquiry into Class Action Proceedings and Third-Party Litigation Funders (December 2018), p.202.
[14] Ibid, p. 205.
[15] Ibid, p. 250.