Association of Litigation Funders of Australia

Submission to Treasury and the Attorney-General's Department

Consultation on guaranteeing a minimum return of class action proceeds to class members

5 July 2021

Level 13, 333 George Street, Sydney NSW 2000

About the Association of Litigation Funders of Australia

ALFA is a professional body established in April 2018 to enhance the Australian litigation funding market by:

- providing education, training and information about litigation funding and the litigation funding market;
- engaging with government, legislators and other policy makers to help shape the legal and regulatory framework of litigation funding in Australia; and
- promoting best practice and ethical behaviour amongst litigation funders in Australia.

The members of ALFA are Augusta Ventures, Balance Legal Capital, CASL, Court House Capital, Investor Claim Partner, Ironbark Funding, Litigation Lending Services, Premier Litigation Funding, Southern Cross Litigation Finance and Vannin Capital.

This submission is made on behalf of the members of the Association and represents their collective views, but it does not necessarily represent the individual views of each member.

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Summary of ALFA's responses to the Consultation Questions

Question 1: What is the best way to guarantee a statutory minimum return of the gross proceeds of a class action (including settlements)?

Question 2: How would the suggested mechanism interact with the class action system (including court processes) and the litigation funding regime?

Questions 3: 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?

ALFA's Response: There should be no statutory minimum return to group members of the gross proceeds from class actions. The long-term effects of such a proposal would be to reduce access to justice and create perverse incentives in the conduct of class actions contrary to the interests of group members. There is a real likelihood that a statutory minimum return would worsen rather than improve potential financial outcomes for group members of funded class actions.

The current regime of regulation of litigation funding costs by the court operates fairly and is effective in protecting the interests of group members. There is no empirical or principled basis for statutory intervention to cap recoverable litigation and funding costs in a class action at 30% of gross proceeds or at any other level.

Question 4: 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?

Questions 5: 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.

ALFA's response to Questions 4-5: There is no such thing as a straightforward class action, and any graduated approach to setting statutory minimum returns for group members in class actions would be unworkable. Assessment of the risk, complexity, and likely proceeds of a class action must be undertaken without hindsight bias, and is a task uniquely suited to the courts.

Question 6: What other implementation considerations would be relevant to the issues raised in this consultation paper?

ALFA's response to Question 6: ALFA opposes the introduction of any statutory minimum return to group members in class actions. However, if such a minimum were to be introduced, it should: only be by reference to net proceeds, i.e. after the deduction of legal costs and disbursements; at a level well below 70%, supported by independent empirical analysis; and

not apply to wholesale or sophisticated claimants or in closed class actions commenced on behalf of persons who have agreed to funding terms on an informed basis.

Further, any legislation or regulations to implement a cap introduced at the Commonwealth level will not apply to Group Cost Orders made in favour of plaintiff lawyers by the Supreme Court of Victoria in class actions commenced in that Court.

Introduction

1 ALFA welcomes the opportunity to make this submission in response to the Treasury and Attorney-General's Department consultation paper on guaranteeing a minimum return of class action proceeds to class members (the 'Consultation Paper').

2 The class actions regime is achieving its purpose of providing access to justice for ordinary Australians who have been wronged by corporate or government misconduct. Litigation funding promotes access to justice by answering the questions of who pays for the costs of class actions and how to protect plaintiffs who represent group members in a class action from the risk of an adverse costs order should the proceeding fail.

3 The existing regulation of litigation funding costs by the courts is operating effectively, delivering outcomes that are fair and reasonable and in the interests of group members. There is no empirical or principled basis to support statutory intervention in the current system to guarantee a minimum return of class action proceeds to group members.

4 ALFA opposes the introduction of a statutory minimum return of the gross proceeds of class actions to group members for the following reasons:

(a) there has been no adequate inquiry into the potential ramifications of the proposed cap on access to justice and the rule of law; particularly in regard to the interests of consumers, workers, investors and the markets within which they are affected by unlawful Corporate and Government behaviour;

(b) these interests, spelt out in Parliamentary legislation and the common law enforced in class actions, are not limited to obtaining compensation when unlawful conduct causes loss;

(c) in addition to putting at risk the billions of dollars that flow to class members from funded claims, the proposed cap has the likelihood of:

(i) diminishing equality of arms, access to justice and therefore enforcement of our laws;

(ii) diminishing the deterrent effect created by the laws;

(iii) increasing unlawful Corporate and Government behaviour; and

(iv) increasing the damage caused to millions of Australians by this behaviour;

(d) these unintended consequences, not yet the subject of any adequate inquiry, have the potential to dwarf any perceived upside of a cap on funder's fees;

(e) the long-term effect would be to reduce access to justice for claimants wronged by corporate or government misconduct by reducing equality of arms between

plaintiffs and defendants and by making many cases commercially unviable for litigation funders to support;

(f) the types of class actions most likely to become unviable are those cases conducted on behalf of the most disadvantaged claimants;

(g) the proposal would likely reduce competition in the Australian litigation funding market, ultimately leading to a rise in funding costs;

(h) a statutory minimum return may actually increase costs in some cases, becoming the default rather than a floor for returns to group members;

(i) it may create conflicts and perverse incentives in the conduct of class action litigation, contrary to the interest of group members;

(j) a statutory minimum return of gross proceeds is likely in some cases to result in outcomes that cannot be justified on any principled basis; and

(k) the proposal would limit the rights of prospective group members to freely contract with a litigation funder on terms that would otherwise be reasonable, appropriate and commercially advantageous to them.

5 A graduated approach to guaranteeing group member returns in class actions would be unworkable, deliver inferior outcomes compared to the current regulation of litigation funding costs by the courts, and continue to suffer from all the problems of a statutory minimum return to group members.

6 ALFA opposes the introduction of any statutory minimum return to group members in class actions on matters of principle and for the reasons set out above. There is simply no evidence that the current regulation by the Court is not working and any statutory intervention should not proceed without a proper independent enquiry into the proposed changes.

7 However, if, despite each of the reasons set out above, such a minimum were to be introduced, it should:

(a) only be by reference to net proceeds, i.e. after the deduction of all litigation costs, rather than calculated on the basis of gross returns;

(b) be set at a level well below 70%, and determined by reference to independent empirical analysis; and

(c) not apply to wholesale or sophisticated claimants or in closed class actions commenced on behalf of persons who have entered into funding agreements on an informed basis.

Litigation funding of class actions promotes access to justice

8 The federal class actions regime was introduced in March 1992 with the aim of improving access to justice, by enabling claims to be brought by people with small claims whose number may be such as to make the total amount at issue significant, but whose claims would not be economically viable to recover in individual actions, and by enabling similar individual claims to be dealt with more efficiently by the court.[1]

9 Twenty-nine years later, it is undeniable that the class actions regime has been successful in achieving its aims. As his Honour Justice Murphy has observed, prior to the introduction of the regime in Australia, "it was either impossible, or at least exceedingly rare, for consumers, cartel victims, shareholders, investors and the victims of catastrophe to recover compensation, even where the misconduct was plain."[2] Since 1992, class actions have enabled claimants, many of them ordinary Australians wronged by corporate or government misconduct, to recover billions of dollars in compensation.

10 Class actions also have had the additional benefit of vindicating statutory policies by penalising wrongdoers and discouraging wrongdoing, supporting the work of the corporate regulators, and promoting the efficient use of court resources, allowing governments to direct resources to other pressing matters.[3]

11 The Australian Law Reform Commission ('ALRC') has observed that, if a criticism could be levelled at the original class actions regime, it was that it left unanswered the difficult questions of who would pay for the costs of prosecuting class actions and how to relieve the representative applicant from the risk of an adverse costs order should the proceeding fail.[4]

12 In Australia, litigation funding has largely provided the answer to both these questions. Litigation funding is generally provided by commercial third-party litigation funders with no direct interest in the litigation, who agree to finance the litigant's legal costs, and usually provide or procure indemnities for the litigant against an adverse costs order, in return for a share of any proceeds if the claim is successful.

13 Commercial litigation funding is now an established part of class action proceedings in Australia. In providing funding for class actions, commercial litigation funders have provided access to justice for many hundreds of thousands of ordinary Australians. Between 2013 and 2018, 64% of class action proceedings filed in the Federal Court

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1 Second Reading Speech by Attorney-General, House of Representatives, 14 November 1991, *Hansard*, at 3174-3175

2 The Hon Justice Bernard Murphy, *Access to justice under the Part IVA regime*, Keynote address at the seminar 'Class Actions - Current Issues after 25 years of Part IVA' (23 March 2017), at 1.

3 Australian Law Reform Commission, *Integrity, Fairness and Efficiency—An Inquiry into Class Action Proceedings and Third-Party Litigation Funders*, Final Report, December 2018, ('ALRC Report'), at 25; The Hon Justice Bernard Murphy, Justice of the Federal Court of Australia, *Access to justice under the Part IVA regime*, Keynote address at the seminar 'Class Actions - Current Issues after 25 years of Part IVA' (23 March 2017), at 8.

4 ALRC Report, at 49.

were funded class actions.[5] It is doubtful that many, if any, of these actions would have been commenced in the absence of litigation funding.

14 In its 2014 report *Access to Justice Arrangements*, the Productivity Commission recognised the role of litigation funders in promoting access to justice in Australia, particularly in the class action context:[6]

> **Overall, litigation funding promotes access to justice, and is particularly important in the context of class actions** where, although action could create additional benefits when viewed from a broader or community-wide perspective, (often inexperienced) claimants might not take action given the scale of their personal costs and benefits.

15 The Productivity Commission also noted that, in addition to financial support, litigation funders bring important expertise and experience to the conduct of class actions for the benefit of representative applicants and group members.[7] For example, funders will supervise the provision of legal services and ensure that costs are minimised. Funders can also play an important organisational role in identifying, contacting and organising group members where it might otherwise be unfeasible for a group of claimants to organise themselves.[8]

16 The outcome and costs of class action litigation are inherently unpredictable and litigation funders adopt significant and uncertain risks in agreeing to fund a class action. Litigation funders not only carry the risk of losing the whole of their investment if the proceeding is unsuccessful, but also carry the burden of any adverse costs orders. Even if the claim is successful, there is often a risk that the funder may be unable to recover its investment because the defendant does not have the funds to satisfy a judgment award or is unable to offer a settlement sum commensurate with group members' damages. The risks adopted by litigation funders in class actions mean they take a rigorous approach in ensuring any proposed action is both meritorious and commercially viable.

17 In a funded class action, the representative applicant and group members are indemnified against any out-of-pocket costs. In this way, litigation funding complements the principle underlying the class actions regime that group members can benefit from the litigation without being required to take an active step in the proceeding, including making any contribution to the costs of conducting the litigation.

18 Having regard to the benefits of funded class actions for group members and the important role of litigation funding in providing access to justice, it should be uncontroversial that litigation funders receive a fair and reasonable return on their investment from the proceeds of a successful class action, which properly reflects the risks undertaken by the funder.

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5 ALRC Report, at 65.

6 Productivity Commission, *Access to Justice Arrangements* (Inquiry Report No 72, 5 September 2014) ('Access to Justice Report') vol 2, at 624 (emphasis added).

7 Access to Justice Report, at 607.

8 Ibid.

Current regulation of litigation funding costs by the court is fair and effective

19 The court exercises a supervisory and protective role in respect of the fees and costs incurred in the conduct of class action proceedings, including litigation funding costs.[9] Under the federal class actions regime and its State equivalents, the court retains the discretion to approve funding costs and does so in accordance with established principles of what is fair and reasonable in the particular case. Regulation of funding costs by the court is effective and fair, and there is no evidentiary basis for statutory intervention in the current system to guarantee a minimum return to group members.

20 Following the commencement of a class action in the Federal Court, any litigation funding agreement must be disclosed to the court and opponents to the action (subject only to redactions of limited parts of the agreement, such as the case budget, which may confer a tactical advantage), and there is an ongoing obligation to disclose to the court and opponents any change in those arrangements.[10] There is also an obligation to notify group members as soon as practicable of the intention to recover a funding commission from any proceeds of the class action.[11] As a result, group members are on notice from an early stage that part of any settlement may be applied towards funding costs. If a group member objects, they have the ultimate remedy available of opting out of the proceeding.

21 Perhaps more importantly, a class action may not be settled or discontinued without the approval of the court.[12] If the court gives such approval, it may make such orders as are just with respect to the distribution of any funds recovered under a settlement, including the approval of legal costs and any funding commission to be recovered from the settlement sum.[13] The principles applicable to settlement approval in a class action are the subject of a well-established body of jurisprudence.[14]

22 The court will only approve the settlement of a class action if the proposed settlement is fair and reasonable and has been undertaken in the interests of group members.[15] In deciding whether the settlement is fair and reasonable, including any proposed commission to be paid to a litigation funder as part of the settlement, the court will consider a range of factors, including: the amount offered to each group member; the prospects of success and the likely duration and costs if the proceeding were to continue to judgment; the attitude of the group members to the settlement; and advice received from senior counsel on the merits of the action.[16]

23 Where the court considers that the commission payable under the litigation funding agreement pursuant to a proposed settlement is excessive or disproportionate, it can refuse to approve the settlement.[17] Alternatively, where the funder seeks a common

9 *Endeavour River Pty Ltd v MG Responsible Entity Limited* [2019] FCA 1719, at [4].
10 Federal Court of Australia, *Class Actions Practice Note (GPN-CA)*, [6].
11 Federal Court of Australia, *Class Actions Practice Note (GPN-CA)*, [16.1].
12 *Federal Court of Australia Act 1976* (Cth), s 33V(1).
13 *Federal Court of Australia Act 1976* (Cth), s 33V(2).
14 ALRC Report, at 130-132.
15 *Williams v FAI Home Security Pty Ltd* (2000) 180 ALR 459, at [19].
16 *Williams v FAI Home Security Pty Ltd* (2000) 180 ALR 459, at [19].
17 *Liverpool City Council v McGraw-Hill Financial, Inc* [2018] FCA 1289, at [22].

fund order as part of the proposed settlement, the court has the power to refuse to approve the settlement at the funding commission rate sought and to indicate that it considers that another funding commission rate would result in a settlement that was fair and reasonable.[18] (ALFA supports the ALRC's recommendation that the federal class action regime be amended to provide the court with an express statutory power to make a common fund order, particularly following the High Court's decision in *BMW Australia Ltd v Brewster*.[19])

24 The considerations to which the court will have regard when determining whether a commission rate is fair and reasonable include: whether the rate avoids excessive or disproportionate charges to group members; whether the rate is commercially realistic and properly reflects the costs and risks undertaken by the funder in the proceeding, avoiding hindsight bias; and how the proposed commission rate compares to approved commission rates in other class actions.[20]

25 As part of the settlement approval process, the court now routinely has the benefit of receiving submissions from a 'contradictor', an independent senior barrister appointed by the court to represent the interests of group members (most of whom will not take any part in the settlement approval hearing), to assist it in deciding whether a proposed settlement is fair and reasonable. The court will generally also receive an opinion from an independent costs referee on the reasonableness of the legal costs sought to be recovered from the settlement sum. The court also has the benefit of any submissions from the respondents, who may also challenge aspects of a proposed settlement scheme.

26 Far from permitting litigation funders to obtain '*windfall*' profits from class actions, as claimed by some advocates for reform, the regulation of funding costs by the court, exercised in accordance with established principles of what is fair and reasonable, ensures that the returns to litigation funders are commensurate with the risks undertaken in funding the litigation. In the instances where the court has not been satisfied that the commission is fair and reasonable, it has refused to approve the proposed settlement. For example, in the Murray Goulburn class action, the funder agreed to a reduced commission after the court initially refused to approve the proposed settlement.[21]

27 In considering whether to approve a proposed funding commission, the court has regularly referred to the foundational research of Professor Vince Morabito, which includes analysis of the funding commissions and fees approved in Australian class actions.[22] Rather than finding that litigation funders are generating excessive profits from class action litigation, Professor Morabito finds that, in the period from 1992 to 2018, the average percentage of settlement funds that were applied towards a funding

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18 *Money Max Int Pty Ltd v QBE Insurance Group Ltd* [2016] FCAFC 148; 245 FCR 191.
19 [2019] HCA 45; (2019) 374 ALR 627.
20 *Evans v Davantage Group Pty Ltd (No 3)* [2021] FCA 70, at [55].
21 *Endeavour River Pty Ltd v MG Responsible Entity Limited (No 2)* [2020] FCA 968.
22 See, e.g. Prof Vince Morabito, 'Common Fund Orders, Funding Fees and Reimbursement Payments' (January 2019).

commission in all funded settled class actions, in addition to the legal costs incurred in the proceeding, was 26.87%.[23]

28 Advocates for removing or fettering the court's discretion to approve funding commissions regularly point to the same cherry-picked examples of class actions where group members received a small portion of the total settlement sum. However, these arguments never address the particular circumstances of those cases. Rather, having regard to the principles applied by the court in approving those settlements, the only reasonable conclusion is that in these rare cases the funding costs recovered by the funder were fair and reasonable in all the circumstances. Professor Morabito's market-based analysis is a far better indicator that the regulation of litigation funding costs by the court is operating effectively in ensuring fair outcomes for group members than any superficial reference to headline rates in outlier cases.

29 Also, a focus exclusively on the returns to litigation funders in successful class actions considers only half the picture. It does not include funded class actions that have been discontinued or unsuccessful at trial, resulting in the loss of the funders' investment and potentially the payment of adverse costs, or actions where a small settlement has been achieved, e.g. where there are limited prospects of recovering a judgment award against the respondent, and the funder has recovered less than their investment.[24]

30 As his Honour Justice Lee observed in *Liverpool City Council v McGraw-Hill Financial, Inc (now known as S&P Global Inc)*:[25]

> Just because these cases have been successful, and the return has been handsome, it does not mean that the funder's business has been successful in other cases where the risks inherent in litigation funding have materialised. **It is all very well focussing on the successful cases, but any fair assessment of reasonable returns must be seen in the context that the risks of litigation funding sometimes come home to roost.**

31 The likely outcomes and costs of class action litigation are inherently uncertain and vary widely according to the idiosyncrasies of the particular case. While litigation funders will assess the risks of a class action before investing, they do so with incomplete, and often very limited, information. They also generally fund actions on an open-ended basis, for an uncertain period, in circumstances where the costs incurred are at least in part within the control of the opposing party and the case management of the proceeding by the court.

32 Commission rates charged by litigation funders reflect the risks and uncertainty associated with class action litigation. They also reflect the benefit to group members in having their claims prosecuted without any out-of-pocket costs or risk of adverse costs order. In its analysis of funding commission rates in Australia, the Productivity

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23 Ibid, at 12.

24 *E.g. Bywater v Appco Group Australia Pty Ltd* [2020] FCA 1537; *Bywater v Appco Group Australia Pty Ltd* [2020] FCA 1877.

25 [2018] FCA 1289, at [56].

Commission concluded that "current commissions charged by funders appear commensurate to the services offered".[26]

33 The multi-factorial approach adopted by the courts in approving funding costs, having regard to risks undertaken by the funder without hindsight bias, permits a proper assessment of what is fair and reasonable in the particular circumstances of the case, subject to the ultimate consideration of the interests of group members. Such an approach is far better adapted to achieve a fair outcome as between group members, the representative applicant, the lawyers and the funder than any pre-determined statutory cap on funding costs or minimum return to group members.

Response to Consultation Questions 1-3: There should be no statutory minimum return to group members of gross proceeds from class actions

34 The questions posed by the Consultation Paper proceed on the false premise that statutory intervention guaranteeing a minimum return for group members in class actions is necessary. The correct starting point for consideration of any change to the existing class actions system is whether such a change would further its purpose of providing and promoting access to justice.

35 While the introduction of a statutory minimum return to group members may improve the outcomes for group members in a small number of cases in the short term, the long-term effect would be to reduce access to justice for ordinary Australians wronged by corporate and government misconduct and create perverse incentives in the conduct of class actions contrary to the interests of group members.

36 The Consultation Paper seeks submissions on a statutory minimum return to group members of 70% of gross proceeds from class actions, i.e. a cap of 30% on all costs paid out of the gross proceeds, including legal costs and disbursements (referred herein as the 'litigation costs') and funding costs, including any costs associated with indemnities and security provided in respect of adverse cost orders. In a class action, the disbursements are often a substantial part of the total costs, and will include barristers' fees, experts' fees, court fees, the fees of any independent costs referee or contradictor, copying and transcription costs, and subpoena conduct money. These costs are rarely, if ever, deferrable.

37 Analysis conducted by PwC of available data on recent settlements in funded class actions found that:

(a) a cap of 30% on total costs would have had implications for 91% of cases, where total costs (i.e. both the litigation and funding costs) exceeded 30% of gross proceeds; and

(b) in 36% of cases, litigation costs alone exceeded 30% of gross proceeds.[27]

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26 Access to Justice Report, at 635.

27 PwC, *Models for the regulation of returns to litigation funders* (16 March 2021), at 14-17.

38 As PwC concludes, the proposed cap on total costs of 30% would therefore have made at least 36% of these class actions (where litigation costs alone exceeded 30% of gross proceeds) commercially unviable.[28] As a result, it can be inferred that the introduction of a statutory cap on the recovery of litigation costs in class actions would have the immediate effect of greatly reducing the number of class actions, with grave consequences for ordinary Australians' access to justice.

39 In the remaining 55% of affected cases considered by PwC (where the litigation costs were less than the proposed cap of 30% of gross proceeds but the total costs including litigation and funding costs exceed 30% of gross proceeds), whether the litigation funder would still have funded the actions on a reduced funding commission would depend on the rate of return required by the funder.[29] Given the fixed costs associated with litigation funding, which involves active specialist management of the investment, and the high and uncertain risks associated with funding class actions, it can be assumed that a large proportion of these cases also would not have been funded, and as a result would not have been run, further reducing access to justice.

40 Even adopting a lower statutory minimum return to group members of 50% of gross proceeds, PwC found that 12% of settled class actions would have been unviable and a further 21% would have been impacted by the cap.[30] This would still result in a drastic reduction in access to justice.

41 There is no empirical or principled basis for capping the litigation and funding costs recoverable in class actions at 30% of gross proceeds or at any other level. In its 2014 report, the Productivity Commission recommended against placing any limit on the returns to litigation funders in class actions, distinguishing the role of a funder from solicitors acting on a contingency basis:[31]

> The first question is whether there should be a limit on the percentage of damages paid to litigation funders (similar to the limits recommended for lawyers…). While there is likely to be some overlap, litigation funders provide a different service to lawyers – they provide funding and manage claims on behalf of clients rather than providing legal advice. As noted above, current commissions charged by funders appear commensurate to the services offered. Further, if a limit is imposed on lawyers using damages-based billing, then to some degree funders' fees will become constrained, as they would have to differentiate their service offering to justify charging higher amounts… Therefore, **the Commission considers that there is no need to place a limit on the fees of litigation funders.**

42 Further, as Nyunggai Warren Mundine recently observed, a statutory cap on litigation and funding costs would disproportionately affect some of the most disadvantaged claimants, for example indigenous claimants seeking the repayment of stolen wages dating back decades, or victims of faulty products, who recently succeeded in obtaining

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28 Ibid, at 16.
29 PwC, *Models for the regulation of returns to litigation funders* (16 March 2021), at 17.
30 Ibid, at 16.
31 Access to Justice Report, at 635 (emphasis added).

damages in a funded class action.[32] Such claims generally often carry significantly greater risks and costs for funders than e.g. shareholder claims which have drawn much of the commentary by advocates in favour of capping funding commissions. A cap on the return to funders would likely make the claims referred to by Mr Mundine unviable, meaning the claims could not proceed and claimants would receive no compensation.

43 The preferable approach to regulating the funding and litigation costs deducted from the proceeds in class actions is one that allows for consideration of the costs and risks involved in each particular case, as the court currently does when it determines whether to approve the settlement of a class action.

44 There are also likely to be broader negative consequences of the introduction of a statutory minimum return for group members, regardless of the rate set, beyond those cases that become immediately commercially unviable to run.

45 Increased competition in the Australian litigation funding market in recent years, with new funders entering the market, has been the key factor in driving down funding costs for class actions over the period. However, the introduction of a statutory minimum return to group members will likely have an adverse impact on competition in the market, leading to a rise in funding costs and ultimately acting to the detriment of prospective group members.

46 Litigation funders do not generally fund cases on an individual basis, but rather fund a portfolio of cases allowing them to diversify their risks. The greater the diversification across the portfolio, the greater the additional risks (i.e. cases) that a funder can take while maintaining an adequate expected rate of return across the portfolio. A reduction in the available return to litigation funders across their portfolios, and a narrowing of the types of class actions that are commercially viable to run, will reduce the ability of some litigation funders to fund the types of riskier class actions involving the most disadvantaged claimants.

47 Litigation funders also have fixed costs, including employing highly skilled specialists to assess potential cases and manage their investments in class actions. To remain economically viable, litigation funders not only need to generate returns from their existing cases, but also need to fund new cases on behalf of investors who provide capital. Reduced rates of return and fewer class actions available to fund would likely lead to investors withdrawing capital from funders, leading to some litigation funding businesses becoming uneconomic and exiting the Australian litigation funding market entirely. This would reduce competition in the funding of class actions and ultimately result in higher costs for group members.

48 There is also a risk that the introduction of a statutory minimum return to group members may actually *increase* the costs approved by the court in some class actions. In its submission to the PJC, Allens opposed the introduction of any statutory cap on

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[32] Nyunggai Warren Mundine, 'Indigenous wages were stolen and they must be repaid', *The Australian* (18 June 2021, online).

funding commissions on the basis that, rather than serving as a maximum, it would become the default amount sought as part of any proposed settlement.[33] The ALRC observed that this has been the experience with uplift fees for solicitors acting on conditional fee retainers.[34]

49 The introduction of a statutory minimum return to group members would also create perverse incentives in the conduct of the litigation, in conflict with the interests of group members. The plaintiff's lawyers and the funder would have an interest in minimising litigation costs and obtaining settlement at an early stage, to ensure a reasonable recovery of litigation and funding costs under the cap, even though this may not maximise the overall return to group members. Currently, under an uncapped percentage-based commission, the interests of group members and the funder are aligned in maximising the total proceeds obtained in the litigation. In appropriate cases, the funder will agree to increase its investment in the case to enable the lawyers to fight longer and harder in order to achieve a more favourable resolution of the case. Funders may not be willing to do this if they are unable to gain an additional return from this incremental investment.

50 Conversely, defendants in class actions would be incentivised to maximise the costs incurred on behalf of the plaintiff, knowing that at a certain point the statutory cap on recovering costs would cause the action to become commercially unviable for the funder and the plaintiff's lawyers, creating settlement pressure. Such an incentive for litigation by attrition is entirely contrary to modern case management principles, and even the risk of such conduct can be expected to create a chilling effect on the funding of class actions. The fair resolution of class action proceedings requires a relative equality of arms which is only usually available to class action plaintiffs with the support of litigation funders. Equality of arms is a prerequisite for access to justice in our adversarial civil justice system.

51 As noted above, the most important factor putting downward pressure on litigation funding costs for class actions has been increased competition between the growing number of litigation funders in Australia. Rather than the introduction of a counterproductive statutory minimum return for group members in class actions, the better approach to promote access to justice for prospective group members would be to encourage participation and competition in the Australian litigation funding market.

Response to Consultation Questions 4-5: A graduated approach to statutory minimum returns would be unworkable and inferior to regulation by the court

52 Contrary to the premise in Consultation Questions 4 and 5, there is no such thing as a straightforward class action, and any graduated approach to setting statutory minimum returns for group members in class actions would be unworkable.

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33 Allens, Submission No. 68 to the Inquiry into litigation funding and the regulation of the class action industry, Parliamentary Joint Committee on Corporations and Financial Services, Parliament of Australia, (11 June 2020), at 12.

34 ALRC Report, at 261.

53 Litigation funders make assessments about the risks and likely proceeds of a class action when deciding whether to fund the litigation, but those assessments are made based on incomplete information, and their accuracy can only be determined at the conclusion of the case. It is impossible to predict with any certainty the risk, complexity, length or likely proceeds of the case at the outset.

54 The assessment of a fair and reasonable return to a litigation funder on their investment must have regard to the risks the funder takes on when funding a class action. This cannot be determined with hindsight (a point that has been expressly accepted by the courts in their approach to settlement approval applications[35]), based on the ultimate outcome or costs incurred, but must be assessed as at the time the case was commenced. Any predetermined statutory scale that caps litigation funding costs, depending on the length of the proceeding or the outcome achieved, would not reflect the upfront risks undertaken by the funder.

55 A statutory graduated approach to classifying class actions according to the risk or complexity of the case also would be unworkable. Class action litigation is highly complex, with no two cases the same. Unlike certain routine types of personal injury litigation, outcomes are not predictable. No two class actions are the same and no two firms of solicitors will run a class action in the same way. Some firms may adopt a riskier or more complex case theory to maximise the potential returns to group members. Others may adopt a more conservative approach in order to reduce costs.

56 Determining group members' returns based on the classification of the risk and complexity of the class action within a predetermined scale will lead to satellite litigation about what class the case falls into, increasing the costs for all parties involved.

57 Judgments about the fair and reasonable returns to group members and the litigation funder in a class action, having regard to the risks, complexity, length and proceeds obtained in the particular case, is a task uniquely suited to judges experienced in class action proceedings. As set out above, this is precisely what the current regulation of litigation funding costs by the courts provides. Further, the courts are not limited to considering a predetermined set of factors when deciding what is a fair and reasonable funding commission. They will assess all the circumstances of the case according to a well-developed body of jurisprudence, with the assistance of independent costs referees and contradictors representing the interests of group members.

58 The courts already take a graduated approach to ensuring that any litigation funding costs are proportionate, and properly reflect the costs and risks undertaken by the funder in the proceeding, having regard to the ultimate consideration of the interests of group members. The current regulation of litigation funding costs by the courts is operating effectively and fairly. Statutory intervention to guarantee returns to group members according to a graduated approach will only deliver inferior outcomes,

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35 See, e.g. *Liverpool City Council v McGraw-Hill Financial, Inc (now known as S&P Global Inc)* [2018] FCA 1289, at [54].

increase costs, and will still suffer from the same problems associated with a single statutory minimum return discussed above.

Response to Consultation Question 6: Any statutory minimum return should be of net proceeds, supported by independent empirical analysis, and preserve freedom of contract

59 ALFA opposes the introduction of any statutory minimum return to group members in class actions on matters of principle and for the reasons set out above. There is simply no evidence that the current regulation by the court is not working and any statutory intervention should not proceed without a proper independent enquiry into the proposed changes.

60 However, if such a minimum were to be introduced, it should:

(a) only be by reference to net proceeds, i.e. after the deduction of all litigation costs, rather than calculated on the basis of gross proceeds;

(b) be set at a level well below 70%, such level to be supported by data and independent empirical analysis;

(c) not apply to wholesale or sophisticated group members or in closed class actions commenced on behalf of persons who have entered into funding terms on an informed basis.

61 First, if a statutory minimum return to group members is set by reference to gross proceeds, it is likely to result in outcomes that cannot be justified on any principled basis. By way of example, assume a litigation funder provides funding for a complex and high-risk product liability case (with a commensurably higher than average commission rate) on behalf of injured consumers.[36] Following a number of years of litigation, after discovery and expensive expert reports have been prepared and $7 million in costs have been incurred, it becomes apparent that group members' claims will fail. Nevertheless, the defendant is prepared to enter into a settlement for $10 million to avoid the matter going to trial. Under the proposed 70% guaranteed minimum return of gross proceeds, group members would receive $7 million for their claims. On the other hand, the funder would be reimbursed only $3 million, meaning they would have suffered a loss of $4 million in funding the litigation.

62 In these circumstances, there can be no justification for group members receiving 70% of the settlement sum for what were determined to be valueless claims, after extensive legal costs were expended investigating the case on their behalf by the litigation funder.

36 See *Kuterba v Sirtex Medical Limited (No 3)* [2019] FCA 1374 at [18].

63 As his Honour Justice Beach observed in *Kuterba v Sirtex Medical Limited (No 3)*:[37]

> **No power contained in or philosophy underpinning [the Part IVA class action regime] provides a proper basis for giving group members something for what turned out to be nothing or to give them something beyond what the true value of their claims are worth**, reflecting the product of the face value times the probability of success times the probability of recovery. Moreover, to so artificially allocate is economically distortive and unnecessarily disincentivises the reasonable investment of time and expense in investigating, funding and prosecuting class actions.

64 Take another example where, although group members' claims have strong prospects, it eventuates that the defendant's assets are insufficient to meet the likely judgment against them and so the matter settles for a sum well below the value of group members' claims.[38] Again, there is no principled basis for guaranteeing a minimum return to group members of gross proceeds in this scenario, shifting the risk of recoverability onto the litigation funder both in recovery of its commission and the litigation costs it has incurred in funding the proceeding.

65 A statutory minimum return to group members of gross proceeds would also create an impossible conflict between the plaintiff's solicitors, who have professional obligations to their client in the conduct of the litigation, and the funder. If the cap is placed on the total costs recoverable from the gross proceeds, all costs incurred in prosecuting the action are not only paid by the funder, increasing its investment, but also reduce the amount available to the funder under the cap to recover as its commission. The perverse effect of such a system would be to decrease the potential return to the funder as its investment increased.

66 As a result, if there is to be statutory intervention to guarantee a minimum return to group members (which is opposed by ALFA for the reasons set out above), it could only be sensibly structured by reference to the *net* proceeds of the class action, after deductions are made for litigation costs and costs associated with providing indemnities and security for adverse costs.

67 Second, any statutory minimum return to group members in class actions must be set at a level based on data and empirical analysis of the impact on access to justice and the litigation funding market in Australia, and any such minimum return should be at a level well below 70% of the proceeds of the action. As set out above, an arbitrary cap of 30% on the litigation and funding costs recoverable in class actions would have drastic negative consequences for access to justice, and disproportionately effect the most disadvantaged claimants. Even a cap of 50% would have severe negative consequences and therefore cannot be justified on any principled basis.

68 There is no data supporting the proposed statutory minimum return to group members of 70% of the proceeds of class actions (or any other percentage) and no guaranteed

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37 [2019] FCA 1374, at [19] (emphasis added).

38 *Evans v Davantage Group Pty Ltd (No 3)* [2021] FCA 70, at [65].

minimum return should be imposed without independent empirical analysis justifying statutory intervention and the level of any such minimum return.

69 Finally, the one-size-fits-all approach proposed by the Consultation Paper appears to proceed on an assumption that litigation funders are price-setters and that group members are required to accept whatever funding charges are imposed by the funder. This fails to acknowledge that in certain types of litigation, group members often include sophisticated, repeat participants in class action litigation, e.g. superannuation funds in shareholder class actions. These wholesale and sophisticated group members have the capacity to go to the funding market to seek the best funding terms for their claims, and often do so.

70 The proposal also ignores the role of class action lawyers in obtaining the best commission rates for litigation funding, and the protection that this affords lead plaintiffs and group members. Not only do class action law firms have professional obligations to act in the best interest of their clients, but in the age of competing class actions, where the likely returns to group members in competing cases may determine which firm gets carriage of the class action,[39] the solicitors have a strong financial incentive to obtain the best funding terms for their actions.

71 The proposed statutory minimum return to group members would also limit the rights of prospective group members to freely contract with a litigation funder for a commission rate that may otherwise be reasonable, appropriate and commercially advantageous to them. This means that where a class action is not commercially viable for a funder to support by reason of the proposed cap, even where informed group members agree to a higher commission rate, the class action could not proceed.

72 The structure of any statutory minimum return to group members must preserve freedom of contract and recognise the market power of sophisticated claimants and class action lawyers to obtain favourable funding terms to fund their claims. At minimum, any statutory regime for guaranteeing minimum returns to group members should exclude funding agreements entered into by wholesale or sophisticated claimants and not apply in closed class actions, commenced on behalf of persons who have entered into funding terms with a litigation funder on an informed basis.

73 Even if the Commonwealth is able to structure a regime for statutory minimum returns that addresses some of these issues, such a regime will not apply to class action lawyers who obtain a 'group costs order' pursuant to recent amendments to the *Supreme Court Act 1986* (Vic). Those amendments permit lawyers acting for the plaintiff in a class action commenced in the Victorian Supreme Court to seek an order, similar to a common fund order, for legal costs calculated as a percentage of an award or settlement that may be recovered in the proceeding.[40]

74 The Victorian group costs order is uncapped, and the likely effect of the introduction of a statutory minimum return to group members by the Commonwealth therefore would

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39 *Wigmans v AMP Limited* [2021] HCA 7,

40 *Supreme Court Act 1986* (Vic), s 33ZDA(1).

be only to redirect class actions from the Federal Court to the Victorian Supreme Court. Meanwhile, claimants in other States who are required to bring proceedings in their local State court for jurisdictional reasons will be shut out.

Conclusion

75 For the reasons set out in this submission, ALFA opposes the introduction of a statutory minimum return of the gross proceeds of a class action to group members, set at any rate or taking a graduated approach.

76 ALFA is grateful to the Treasury and Attorney-General's Department for the opportunity to provide this submission and would welcome the opportunity to answer any questions about the matters raised in its submission or to provide any further assistance.