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'Guaranteeing a Minimum Return of Class Action Proceeds to Class Members'

Submission to Treasury and Attorney-General's Department Joint Consultation

28 June 2021

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Introduction

1 We welcome this opportunity to make a submission to the Treasury and Attorney-General's Department consultation on guaranteeing a minimum return of class action proceeds to class members.

2 The Allens disputes team has a long history of acting for respondents in class actions. We have been involved in class actions in the federal and state courts across a broad range of contexts including shareholder, product liability, consumer protection, financial products, cartel, environmental damage, natural disaster, human health and employee rights. We have also been involved in the ground-breaking claims that have shaped modern class action practice – including the first major funded class action, the first 'closed class' class action, the first shareholder class action to go to trial, the first cartel class action, the first class action in which 'funding equalisation' was ordered, the first case in which a common fund order was made, and the more recent cases in which common fund orders and class closure orders were disallowed. This experience gives us a unique perspective from which to comment on the issues raised by this consultation.

3 Allens has advocated reform to the class action regime for many years. We have made detailed submissions to the class action inquiries conducted by the Parliamentary Joint Committee on Corporations and Financial Services (***Parliamentary Inquiry***),[1] the Australian Law Reform Commission (***ALRC Inquiry***),[2] and the Victorian Law Reform Commission (***VLRC Inquiry***).[3] For a number of years we have also conducted detailed analyses of class action filings to paint a picture of the changing class action landscape, and have released an annual Class Action Risk report setting out key observations and trends.[4]

4 We consider that the objectives of the class action regime require the interests of both applicants and respondents to be given fair and balanced consideration. Of particular concern to us is the increasing entrepreneurialism of plaintiff lawyers and litigation funders, which has resulted in conduct that appears to prioritise the interests of lawyers or litigation funders over the interests of class members and has become the defining feature of Australia's class action environment.[5]

5 Below, we respond to the issues raised by the Consultation Paper. While our submission addresses reform to the federal regime, we consider that ideally any reform would be enacted consistently across the federal and state regimes.

Background

6 The lack of oversight of the litigation funding industry has in some cases exposed litigants to disproportionate costs, with a significant proportion of class action settlements going to lawyers and funders. This has not been fully addressed by the recent regulatory changes[6] to bring funders within the financial services licensing regime, and we welcome the opportunity for further consultation in this regard.

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[1] Allens submission to the Parliamentary Joint Committee on Corporations and Financial Services Inquiry into litigation funding and the regulation of the class action industry (June 2020) (***Allens Parliamentary Inquiry Submission***): https://www.aph.gov.au/DocumentStore.ashx?id=dabb7ffc-d440-478b-aaf9-f37b72c5df99&subId=684848

[2] Allens submission to the ALRC, Inquiry into Class Action Proceedings and Third Party Litigation Funders (August 2018): https://www.alrc.gov.au/wp-content/uploads/2019/08/52_allens.pdf.

[3] Allens Submission to the VLRC, Litigation Funding and Group Proceedings (September 2017): https://www.lawreform.vic.gov.au/sites/default/files/Submission%2012_Allens_22-09-17.pdf.

[4] Our most recent report, Class Action Risk 2021, was released in March 2021 and is available here: https://www.allens.com.au/insights-news/insights/2021/03/class-action-risk-2021/.

[5] These issues are addressed in the Allens Parliamentary Inquiry, Allens ALRC and VLRC Submissions, as well as our Class Action Risk 2021 report: https://www.allens.com.au/insights-news/insights/2021/03/class-action-risk-2021/.

[6] *Corporations Amendment (Litigation Funding) Regulations 2020* (Cth).

7 Courts have a crucial role to play in the oversight of funded class actions. This includes through the exercise of judicial discretion in considering whether a proposed class action settlement is a fair and reasonable compromise of the claims made on behalf of class members.[7] In discharging this duty, the Court is required to have regard to the particular circumstances of each case in approving any settlement of a class action pursuant to s 33V of the *Federal Court of Australia Act 1976* (Cth) (***Federal Court Act***).

8 The significance of the Court's supervisory role in class actions is sharpened when regard is had to the fact that:

(a) the majority of persons affected by a class action are not parties to the proceeding; and

(b) respondents to class actions do not ordinarily play an active role in the settlement approval stage (having settled their interest in the proceeding and having no likelihood of recovering any further legal costs incurred).

9 In the absence of any statutory requirement for a contradictor to appear in relation to the funding commission, legal fees and other costs commonly incurred in class actions, settlement hearings have proceeded as de facto ex parte applications, where there has been little, if any, impetus on the part of funders or plaintiff lawyers to challenge funding commissions or lawyers' fees, often to the detriment of class members' interests.

'Gross proceeds'

10 The Parliamentary Inquiry report and the Consultation Paper refer to the concept of 'gross proceeds' accruing to class members. We have assumed this to mean the total amount paid by a class action respondent pursuant to a settlement or final judgment, including any amounts that are deducted to pay either a funding commission or legal costs.

11 The Consultation Paper focuses primarily on mechanisms for limiting the payment of funding commissions, rather than fees charged by plaintiff lawyers for their legal services. These two types of costs are different in nature. Amounts deducted for legal costs are to reimburse costs actually incurred in running the case, through work performed by lawyers (whether at standard hourly rates or pursuant to other forms of fee arrangements). Funding commissions compensate the funder for the risk it has borne in funding the case, and are in essence a form of investment return.

12 Some of the concerns outlined in this submission could be addressed if legal fees were removed from the scope of the statutory minimum return. However, the minimum return would then simply become a cap on funding commissions which, as outlined below, we also have concerns with.

A guaranteed floor for returns to class members

Statutory minimum return to class members

13 We understand from the Consultation Paper that the introduction of a statutory guaranteed minimum return to class members is intended *in effect* to operate as a pricing control on litigation funders and plaintiff lawyers.

14 As indicated in our submission to the Parliamentary Inquiry, we do not support the introduction of a statutory cap on funding commissions.[8] For the same reasons, we do not support the introduction of a statutory guaranteed minimum return to class members, which is essentially the other side of the same coin.

[7] See e.g. *Lopez v Star World Enterprises Pty Ltd* [1999] FCA 104, [15] and *Jarra Creek Central Packing Shed Pty Ltd v Amcor Limited* [2011] FCA 671, [70].
[8] See Allens Parliamentary Inquiry Submission, page 12 at [18].

15 Our concerns with a minimum guaranteed return to class members are that:

(a) There is a risk that the introduction of a minimum guaranteed rate of return will actually increase fees and commissions paid by class members. Rather than serving as a maximum, the statutory cap may come to be seen as a default rate, with plaintiff lawyers and funders only decreasing their rates below the capped amount in cases where there is a risk they will be undercut (for example, where there is a competing class action).

(b) A minimum guaranteed rate of return will not have the desired effect of decreasing the dollar amount that plaintiff law firms and funders seek to recover in more marginal cases. Rather, there is the potential for rational settlement discussions to be distorted by plaintiff law firms and funders unwilling to resolve matters for an amount that would see them receive less than their full expectation. In many situations the full complexities and challenges of a claim are not apparent until a late stage of the proceeding. It would not be in the interests of class members to lose the ability to receive some compensation in those situations, even if the proportionate share of litigation funders and lawyers is higher than would otherwise be desirable.

16 A statutory minimum guaranteed return to class members is also a blunt instrument. It would not provide the flexibility required by the variety of cases that come before the courts. For example:

(a) in *Evans v Davantage Group Pty Ltd (No 3)* [2021] FCA 70, the Federal Court approved a class action settlement in which registered class members received 37.4% of the settlement sum. However, because the number of class members who registered to participate in the settlement was small compared with the total number of class members, the registered class members were 'likely to receive close to 100% of their claims plus interest'.[9] Had a statutory minimum return of 70% or even 50% been in force, then the settlement in that proceeding could not have been approved. Instead, the risk is that the respondent may have been put in a position of having to choose between proceeding with the matter (ie not reaching a settlement) or 'grossing up' the sum offered to ensure that the litigation funder received a return that was acceptable to it and also that class members received 70% of that sum. This would have meant registered class members received a windfall gain that was significantly more than the amount they had each claimed.

(b) A statutory minimum guaranteed return would not be feasible in a situation in which a representative applicant and a respondent agree that the applicant will withdraw its claim and the respondent will pay the legal costs incurred to date. In circumstances where other class members are free to bring their own claims if they wish (ie their claims are not extinguished), there is no basis for requiring a respondent to pay many times the amount of those legal costs to achieve a 'walk away' outcome from unmeritorious claims.

17 A statutory minimum guaranteed return also examines the benefits of class actions through a purely financial lens, and could not accommodate a situation where declaratory or injunctive relief is a significant part of the claim. For example, it would not provide a basis for measuring the proportionality of the legal costs and commissions where the applicants sought declarations that they are not bound by some onerous agreement, or that a respondent be ordered to cease engaging in some form of conduct.

A graduated approach

18 Consultation Paper question 4 envisages a graduated approach under which 'even higher returns are guaranteed for class members in more straightforward cases'.

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

19 In our experience, class actions are rarely 'straightforward' and involve significant costs in both their prosecution and defence. Class actions typically deal with complex questions of liability or loss, and involve debates about detailed and diametrically opposed expert reports. It is difficult to see how a line could be drawn between those cases that are 'straightforward' and those that are not.

20 In any event, it is unclear how a graduated model would involve an assessment different from the one that is conducted by the Courts in approving settlements, for example under section 33V of the *Federal Court Act*, pursuant to which a settlement will only be approved where the settlement is a fair and reasonable compromise of the claims made on behalf of class members.

21 An alternative approach to those proposed by the Consultation Paper, which would not fully alleviate the concerns expressed in paragraphs 15 to 16 above (but which would ameliorate them to an extent) would be to introduce a presumption that a compromise is not fair and reasonable unless the return to class members exceeds a certain proportion of the gross proceeds (or, put another way, the legal costs and funding commission do not exceed a specified proportion of the overall settlement amount).

22 That presumption could be applied unless the Court determined that a particular threshold was met. One of a number of possible thresholds could be adopted, for example a presumption that applies unless the Court finds that:

(a) it is in the interests of justice for a lower class member return to be allowed – this is our preferred formulation because it encompasses the interests of class members, respondents and also the wider public (for example through the use of Court resources);

(b) it is in the interests of class members for a lower class member return to be allowed;

(c) it is appropriate in all the circumstances for a lower class member return to be allowed; or

(d) having regard to the risk, complexity, length and likely proceeds of a case, it is appropriate for a lower class member return to be allowed.

23 Adopting this approach would allow the Court flexibility to approve bespoke settlement and funding arrangements in the cases that most require them, but would still imprint on the legislation the expectation that class actions be run predominantly in the interests of class members rather than the financial interests of lawyers and funders.

Additional issues: statutory power to review and vary funding commission rate

24 We consider that an appropriate way to address the concerns expressed in the Parliamentary Inquiry report would be for the Court to have an express statutory power to review and vary the funding commission rate and the amount of legal costs as part of any settlement approval or final judgment, if the Court considers that rate to be disproportionate or excessive in all the circumstances of the case. The Parliamentary Inquiry, ALRC Inquiry and VLRC Inquiry all recommended the introduction of a statutory power to that effect.[10]

25 Such an approach could be achieved through amendments to Part IVA of the *Federal Court Act*, with any new statutory power including a provision prescribing relevant matters that the Court may (or must) have regard to in the exercise of judicial discretion to vary a funding commission or to vary the amount of legal costs that can be recovered. An express statutory power of this kind (in a manner not dissimilar to, for example, s 22 of the *Australian Consumer Law*[11] in respect of

[10] Parliamentary Joint Committee on Corporations and Financial Services, *Litigation funding and the regulation of the class action industry: Report* (December 2020) 158, Recommendation 11; ALRC, *Integrity, Fairness and Efficiency – An Inquiry into Class Action Proceedings and Third-Party Litigation Funders: Final Report* (December 2018), 169, Recommendation 14 (***ALRC Report***); VLRC, *Access to Justice – Litigation Funding and Group Proceedings: Report* (March 2018), 123, Recommendation 24 (***VLRC Report***).
[11] Schedule 2 to the *Competition and Consumer Act 2010* (Cth).

unconscionable conduct) would achieve the policy outcome underpinning the proposal to guarantee a minimum return to class members, without having the unintended consequences of potentially increasing the costs of class actions and stifling settlements due to any floor or cap being seen as the 'baseline' for funders and plaintiff lawyers.

26 The statutory power to vary funding commissions could be coupled with the introduction of an express requirement that the Court appoint a barrister to appear as contradictor to appear at all class action settlement approval hearings on the question of the appropriate and reasonable funding commission and legal costs, in order to ensure class members' interests are represented.