BCA
Business Council of Australia

Submission on exposure draft legislation

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

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Overview

This is the submission of the Business Council of Australia in response to the exposure draft *Treasury Laws Amendment (Measures for Consultation) Bill 2021: Litigation funders,* released by the Treasury on 30 September 2021 (**the Bill**).

The Bill is strongly supported by the BCA. The current system of class actions and litigation funding is failing class members. It allows for funders and lawyers to maximise their own profits at the expense of class members.

In 2019, 61 per cent of the compensation award for shareholder class actions in Australia went to litigation funders and lawyers, leaving less than 40 per cent for class members. In 2018, when litigation funders provided funding for class actions, the median return to class members was 51 per cent, compared to 85 per cent in non-funded matters.

A guaranteed minimum rate of return for class members should be implemented as an urgent priority. The BCA is a longstanding supporter of reform to class actions in order to benefit class members. Our previous submission[1] to the 2021 Consultation Process *"Guaranteeing a minimum return of class action proceeds to class members"* considered the various reform proposals that are now reflected in the Bill. A number of points made in that submission are now repeated in this submission. The BCA also strongly supported recent reforms by the Commonwealth Government to restore the rules under which litigation funding arrangements are treated as Managed Investment Schemes (**MIS**) and for funders to be required to hold an Australian Financial Services Licence (**AFSL**).

The proposal for a guaranteed minimum return was also a key recommendation of the 2020 report of the Parliamentary Joint Committee on Corporations and Financial Services inquiry into *"Litigation funding and the regulation of the class action industry"* (**PJC Report**). The PJC Report followed the report of the Australian Law Reform Commission of December 2018 *"Integrity, Fairness and Efficiency – An Inquiry into Class Actions Proceedings and Third-Party Litigation Funders"* (**the ALRC Report**), which also considered similar issues.

The urgent need for reform

Class actions play an important role in providing individuals with access to justice in response to corporate or government wrongdoing and can make the legal system more efficient when used appropriately. However, some practices in class action litigation are contrary to the goal of ensuring that such actions expand access to justice for a wider range of people, rather than providing opportunities for those that run and fund the proceedings to earn disproportionate returns.

The litigation funding environment in Australia is now characterised by funders gaming the system to take advantage of the perverse incentives that enable them to make windfall profits, all of which are at the expense of the class members who have actually suffered damage. In the current environment, the primary determinant of which class actions get run is the potential return to funders rather than the damage suffered by class members or the potential redress for class members.

The greater the return for the funders, the lower the return for the class members. In one case in the New South Wales Supreme Court, the Court described the return sought by the litigation funder as *"stratospheric, in the tens of thousands of per cent."*[2]

Australia's class action system is currently failing to achieve its original objectives of expanding access to justice and generating more efficient use of the court system. As such, the class action industry in its current form is failing those whose interests should have priority – the class members themselves – whilst also generating

[1] https://www.bca.com.au/guaranteeing_a_minimum_return_of_class_action_proceeds_to_class_members_submission_to_treasury_consultation_paper

[2] *Tredrea v KPMG Financial Advisory Services (Australia) Pty Ltd* (No 3) [2019] NSWSC

considerable costs for defendants, which are ultimately picked up by shareholders (for companies) or taxpayers (for governments).

Any reforms in this area need to restore the primacy of the interests of class members. As such, they should be uncontroversial. The BCA endorses the conclusion of the PJC Report that *"those who most fiercely resisted comprehensive regulation of the industry were the vested interests who benefited from the status quo."* [3]

Recommendations

We recommend the following amendments to the Bill:

1. Exemptions to the 70% minimum return should only apply in exceptional circumstances

The rebuttable presumption that a return to class members below 70% is not "fair and reasonable" should be strengthened to include a further requirement that a court must apply the presumption unless it is satisfied that there are exceptional circumstances.

2. The "fair and reasonable" test for funding agreements should also apply to common fund orders

Courts should also be required to apply the "fair and reasonable" test when making common fund orders, including the rebuttable presumption that a return below 70% is not "fair and reasonable". The requirements to consider a referee report and representations made by a Court-appointed contradictor should also apply.

3. Court powers to consolidate class actions

Courts should have greater powers to rationalise overlapping class actions to promote efficiency and maximise benefits for class members. This can be done through amending the *Federal Court of Australia Act 1976* or through the Managed Investment Scheme regime, in which litigation funders (as proponents of an MIS) are obliged to participate in a court rationalisation process wherever necessary.

4. Class members should be free to opt-in and opt-out of classes

Funding agreements established by Funders for the purposes of class action litigation should be required to be non-exclusive. No class member should be restrained from being a member of any other scheme for the funding of litigation in relation to the matter in question.

5. Prohibit contingency fees

Contingency fees for lawyers should be prohibited for class actions in all jurisdictions, to the extent possible.

[3] Parliamentary Joint Committee on Corporations and Financial Services "***Litigation funding and the regulation of the class action industry***", December 2020, page xiv

Comments on features of the Bill

Class members must opt-in to the scheme:

The Bill will require all members of a class to opt-in to the class in writing.[4] This requires a funder to demonstrate that it does, in fact, represent a genuine, identifiable class of persons with a clearly identifiable cause of action, based on the actual circumstances of class members. The process will help quantify a claim and aid any settlement discussions. As recommended above, class members must also be free to opt-out in favour of any competing class action should they wish.

Court oversight of fees:

The Bill will require all class action funding arrangements to be set out in a funding agreement which must be approved by a court, and which can also be varied by the court.[5] Before approving a funding agreement, the court must (unless not in the interests of justice):

- receive a report of a cost reviewer; and
- appoint a contradictor and have regard to his or her views

The funder must cover the costs of each of these parties. This represents best practice and assists the court to make informed decisions about funding arrangements. These measures have proven their worth when they have been used. The Bill could provide more guidance as to the criteria to be used in selecting these parties and scoping their work, but the courts should be capable of appropriately utilising these resources.

Fairness of funders' fees

The Bill will introduce a *"fair and reasonable"* test that courts must apply in approving a funding scheme.[6] In applying this test, the court may only have regard to:

- the expected amount of the claim, the legal costs (and their reasonableness)
- whether the action is being managed in the best interests of class members and the complexity and duration of the matter
- the funder's commercial return relative to the costs incurred by the funder
- the risks accepted by the funder
- the sophistication and bargaining power of class members
- any other compensation or remedies available to the members (including recovery of costs from the defendant)

The Bill also includes a rebuttable presumption that any recovery by class members of less than 70% of the gross proceeds of the claim is not fair and reasonable.[7]

While a sliding scale could have been used, to ensure a much greater recovery percentage will apply for larger claims where appropriate, it is hoped that the court's oversight, informed by the reviewer and contradictor, will ensure that this occurs in practice.

There is a risk, though, that, in cases where only one funder comes forward, the funder might see the potential to use this as leverage to argue for a lower percentage recovery by class members on the basis that it is not prepared to fund the matter unless it receives a higher return, giving rise to a temptation to allow the matter to

[4] Clause 601GA(5)
[5] Clause 601LG
[6] Clause 601LG(3)
[7] Clause 601LG(5)

proceed with a lower recovery threshold. This should not be a sufficient basis for the court to approve a lower return to class members.

For this reason, the Bill should make it clear that a recovery below the minimum 70% threshold can only be provided for in truly exceptional circumstances. We recommend that the Bill be amended to include an additional requirement to the effect that the court must apply the presumption that a claim proceeds distribution method is not fair and reasonable if less than 70% of the claim proceeds for the scheme is paid or distributed to the scheme's general members as a whole, unless it is satisfied that there are "exceptional circumstances".

"Fair and reasonable" test should also apply to common fund orders

Under the Bill as drafted, the "fair and reasonable" test (including the rebuttable presumption that any recovery by class members of less than 70% of the gross proceeds of the claim is not fair and reasonable)[8] does not apply where the court makes a common fund order.[9] In addition, the court is not required to receive and consider a referee report, or representations by a court-appointed contradictor in making a common fund order.[10]

If, and to the extent that, a common fund order can be made by the court,[11] the effect of such an order is very often to fix the funder's remuneration as a portion of the claim proceeds in much the same way as a funding agreement. Accordingly, the court should also be required to the apply the "fair and reasonable" test when making a common fund order. There is no policy reason why the same principles should not apply to both. The Bill as currently drafted creates a loophole in which a party may seek to avoid the "fair and reasonable" test by simply applying for a common fund order.

For this reason, the Bill should be amended to also provide that the court must:

- apply the "fair and reasonable" test when making any order fixing the funder's remuneration for the scheme; and
- receive and consider a referee report, and consider the representations made by a court-appointed contradictor, before making any order fixing the funder's remuneration for the scheme.

This could at least be made a requirement where the court is exercising federal jurisdiction, which would cover shareholder claims under the Corporations Act and claims under other Commonwealth legislation, such as the Australian Consumer Law.

Finally, we note that common fund orders require group members who have not entered into a funding agreement to pay commission to a funder, whereas fund equalisation orders require group members who have not done so to contribute to the commission paid to a funder by other group members who have entered into a funding agreement.

Importantly, where a fund equalisation order is made, the funder's commission is payable by the group members who entered into the funding agreement pursuant to the terms of the agreement (which, under the Bill, would be subject to the "fair and reasonable" test). In contrast, where a common fund order is made, the funder's commission is payable pursuant to the court's order (which, under the Bill, would not be subject to the "fair and reasonable" test).

The power of courts to make a common fund order as a part of a settlement approval is yet to be determined by the High Court. If courts do have the power to make common fund orders as part of settlement approval, this could significantly undermine the proposed reforms because, as noted above, common fund orders may apply to group members who have not entered into a funding agreement.

[8] Clause 601LG(3)-(5)
[9] Clause 601LF(2)(c), (3)(d) and (4)(d)
[10] Cf. clause 601LG(6)
[11] See *BMW Australia Ltd v Brewster* (2019) 374 ALR 627

The need for clear methodology for distribution of proceeds

The Bill will introduce new requirements for funding agreements, which will be required to contain a *"claim proceeds distribution method"* that specifies how the claim proceeds will be paid or distributed to the class members.[12] The methodology must be spelt out in each agreement. This will help all parties assess the size of the claim and how the class members will participate in any recovery. This might change as the matter proceeds, so there should be an ability to amend it.

Court selection for class actions

The Bill will apply to class actions brought in federal courts; State and Territory courts exercising federal jurisdiction; and State and Territory courts not exercising federal jurisdiction.[13] The Bill will capture funding agreements in all jurisdictions by virtue of them being regulated as Managed Investment Schemes. This ought to prevent forum shopping in favour of a jurisdictions that are likely to be more favourable to the interests of funders.

Contingency fees and conflicts of interest for funders and lawyers

The Bill, if enacted, would still allow for a loophole in the class action regime that would enable law firms that fund their own costs without an external funder to escape the operation of the MIS regime and thus not be required to hold an AFSL. This may not be an uncommon scenario and certain firms may attempt to change their funding arrangements in order to run class actions under such a model.

There is a strong case for law firms who undertake class actions on this basis to be regulated on the same basis as other commercial parties – by holding an AFSL, establishing an MIS and being regulated in the same way. There might be a threshold below which minor matters do not require this, to reduce the regulatory burden.

Efficiency hearings to rationalise competing class actions

The Bill does not require a court to take action in the event of multiple class actions covering the same subject matter, and to consider whether the court should order that the proceedings be rationalised into a single proceeding in the interests of efficiency.

It would be a significant missed opportunity if this issue was not addressed in the Bill or in parallel reforms. One of the key virtues of class actions is that they enable greater efficiency and economies-of-scale for plaintiffs by dealing with common claims on a collective basis. This advantage for plaintiffs is substantially diminished where there are multiple claims litigating the same subject matter.

Currently plaintiffs, defendants and the courts often have to grapple with multiple competing actions, which add materially to costs and inefficiency.

At present, there is nothing to prevent multiple class actions being filed against the same defendant covering the same subject matter and the same class members. Courts should have greater powers to rationalise multiple claims. It has been estimated that around 34 per cent of all class action claims filed in Australia have overlapped with other claims.[14]

The BCA endorses the findings of the PJC Report that:

> *"Separate and concurrent class actions which litigate the same legal claims, for the same or overlapping class members, against the same defendant, undermine the objectives of the class action, which is for a single decision to resolve many claims that are the same or similar."* [15]

[12] Clause 601GA(5)(b)
[13] Clause 601LF(2)-(4)
[14] Herbert Smith Freehills, submission to PJC Inquiry, page 2
[15] PJC Report, page xvi

The BCA also supports the recommendation of the PJC Report that Part IVA of the *Federal Court of Australia Act 1976* be amended to provide an express power for the court to rationalise competing class action claims where appropriate.[16] Ideally, this should occur within 60 days of a party commencing a class action. During this time the court should be required to hear from each class action proponent the basis of their case, how they propose to run it and then determine the most appropriate action to then go forward, with all class members embraced by that action, to close off the potential for subsequent actions based on the same set of facts. Any members of a class/MIS providing funding to an action which is stayed as a result of such order should have the right (but no obligation) to join a class/MIS associated with an action that is proceeding.

In addition (or as an alternative), the government may wish to consider introducing a mechanism into the licensing regime to require the holders of an AFSL which has established an MIS for the funding of a class action to participate in a process supervised by a court or other body to achieve the same result.

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[16] Recommendation 2