CONSULTATION ON EXPOSURE DRAFT LEGISLATION TREASURY LAWS AMENDMENT (MEASURES FOR CONSULTATION) BILL 2021: LITIGATION FUNDERS

SUBMISSION OF LITIGATION CAPITAL MANAGEMENT LIMITED
6 October 2021

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PART A: LITIGATION CAPITAL MANAGEMENT LTD

1. Litigation Capital Management Limited and its subsidiaries ("LCM") is a provider of litigation finance products and from that perspective makes the following submission in response to consultation on the exposure draft of "Treasury Laws Amendment (Measures For Consultation) Bill 2021: Litigation Funders" ("Exposure Draft").

2. Founded in 1998, LCM was one of the first professional litigation funders in Australia, and it is one of the longest-standing litigation funders globally. LCM holds an Australian Financial Services Licence and is a publicly listed Australian company, headquartered in Sydney and with offices in Melbourne, Brisbane, Singapore and London.

3. Since its inception, LCM has continued to assist claimants to pursue meritorious claims and recover funds from the legal avenues and actions available to them. LCM funds commercial, insolvency and arbitral proceedings, as well as representative actions.

PART B: EXECUTIVE SUMMARY

4. By this submission, LCM responds to the Exposure Draft as follows:

    4.1. Part C of this submission outlines apparent errors in the Exposure Draft by which the wording of the proposed legislation is inconsistent with its Explanatory Materials. LCM submits that it is critical for amendments to be made in order for these errors to be addressed;

    4.2. Part D of the submission comments on the Exposure Draft deeming class action litigation funding schemes to be managed investment schemes ("MIS");

    4.3. Part E of the submission comments on guaranteed minimum returns to class members; and

    4.4. Part F of the submission comments on the Exposure Draft's broader detriment, including the curtailment of 'open' class actions and conversion of class actions into an 'opt-in' model, fettering of judicial discretion, and setting a precedent for Australian financial products and investment schemes.

PART C: EXPOSURE DRAFT ERRORS

5. LCM submits that there are apparent errors within the text of the Exposure Draft, which must be rectified in order to ensure that the Bill meets its stated objectives without causing dramatic unintended consequences. These issues arise in respect of:

    5.1. The definition of "class action litigation funding scheme" (section 9AAA);

    5.2. The definition of "class action proceedings" (section 9);

    5.3. The definition of "common fund order" (section 601LF(2)(c));

    5.4. The definition of "claim proceeds" (section 9);

    5.5. The costs chargeable by a Responsible Entity (section 601GA(5)(e));

5.6. The definition and treatment of "legal costs" (sections 9 and 601LG); and

5.7. The transitional provisions (section 1688).

"Class action litigation funding scheme"

6. Both the title of the definition itself and the content of the Explanatory Materials make it plain that the definition of "class action litigation funding scheme" is to only relate to class actions. By way of just one of many available examples, the Explanatory Materials at [1.34] state:

"A class action litigation funding scheme is a scheme in which a litigation funder seeks to fund a ***class action proceeding*** *for the benefit of the scheme's general members"* (Our emphasis)

7. However, nothing in the words of the drafted definition actually limit its application to class action proceedings.

8. Not only does the section not mention class actions or any defining markers of a class action, it refers to seeking remedies for "one or more" persons. This clearly includes claims that seek remedies for one person and, in any case, less than seven persons, which claims are not able to be commenced as a class action.

9. As presently drafted, the wording of the definition could apply to any claim in any Court, including personal injury, minor civil, debt recovery or insolvency actions. The consequent risk that all funding, of all claims, in all Courts could be included into the definition and thereby deemed to be an MIS would cause drastic and obviously unintended consequences for such actions.

10. For completeness, LCM notes that the *Federal Court of Australia Act* (Cth) 1976 ("FCA Act") defines a class action representative proceeding as a proceeding commenced under that Act's section 33C, which states:

"33C *Commencement of proceeding*
(1) Subject to this Part, where:
(a) ***7 or more persons*** *have claims against the same person; and*
(b) the claims of all those persons are in respect of, or arise out of, the same, similar or related circumstances; and
(c) the claims of all those persons give rise to a substantial common issue of law or fact;
a proceeding may be commenced ***by one or more of those persons as representing some or all of them****."*
...
(Our emphasis)

11. LCM submits that for ideal drafting the definition of "class action litigation funding scheme" should exactly mirror the above definition.

12. However, at an absolute minimum, LCM submits that it is imperative that the wording of the definition must be amended as follows:

"A scheme that has all of the following features is a class action litigation funding scheme:

(a) the dominant purpose of the scheme is to seek remedies to which ~~*one*~~ ***seven*** *or more persons (the claimants) may be legally entitled arising out of:*

(i) the same, similar or related transactions or circumstances that give rise to a common issue of law or fact; or

(ii) different transactions or circumstances but the claims of the claimants can be appropriately dealt with together;

(b) the possible entitlement of each of the claimants to remedies relates to transactions or circumstances that occurred before or after the first funding agreement (dealing with any issue of 24 interests in the scheme) is finalised;

(c) the steps taken to seek remedies for each of the claimants include one or more lawyers providing services in relation to:

(i) making a demand for payment in relation to a claim; or

(ii) lodging a proof of debt; or

(iii) commencing or undertaking legal proceedings under ***Part IVA of the Federal Court of Australia Act (Cth) 1976 or corresponding provisions of State Court Acts****; or*

(iv) investigating a potential or actual claim; or

(v) negotiating a settlement of a claim; or

(vi) administering a deed of settlement or scheme of settlement relating to a claim;

(d) a person (the funder) provides funds or indemnities, or both, under an agreement (the funding agreement) (including an agreement under which no fee is payable to the funder or lawyers if the scheme is not successful in seeking remedies) to enable the claimants to seek remedies;

(e) the funder is not a lawyer or legal practice that provides a service for which some or all of the legal fees or disbursements, or both, are payable only on success;

(f) if commenced, legal proceedings to seek remedies for each of the claimants would be commenced under Part IVA of the Federal Court of Australia Act (Cth) 1976 or corresponding provisions of State Court Acts."

13. LCM stresses that without the above amendment, the proposed Bill will have potential application to all funded matters, which is clearly contrary to its stated intention. The implementation of the Exposure Draft in its current form will force all funders operating in Australia to seek urgent and immediate relief from the Australian Securities and Investments Commission ("ASIC").

"Class action proceedings"

14. Building on the above comments in relation to "class action litigation funding scheme", the definition of "class action proceedings" suffers from the same error and again makes no reference to class actions or any defining markers of a class action.

15. For the reasons stated above, LCM submits that, at an absolute minimum, it is also imperative that the wording of this definition must be amended as follows:

"***class action proceedings****, for a class action litigation funding scheme, means legal proceedings in a Court* ***commended under Part IVA of the Federal Court of Australia Act (Cth) 1976 or corresponding provisions of State Court Acts*** *to seek remedies for each of the scheme's general members, whether or not remedies are also sought in the proceedings for one or more other persons."*

"Common fund order"

16. At [1.28], the Explanatory Materials state:

> *"Litigation funders cannot enforce the claims proceeds distribution method if, in the relevant class action, the Court makes an order to impose the funder's fee or commission on claimants who are not members of the class action litigation funding scheme (a common fund order).* ***Such orders do not include orders that ensure all claimants (including those who are not members of the class action litigation funding scheme) contribute to the legal costs of the proceeding***." (Our emphasis)

17. LCM submits that the drafting of the "common fund order" definition lacks clarity and can be interpreted as contradicting the above Explanatory Materials.

18. Therefore, LCM submits that the definition ought to be amended as follows:

> "(c) in, or in relation to, the proceedings, the Court does not make an order (a ***common fund order***) for the purposes of:
> (i) fixing the remuneration (however described, ***but not including contributions to the reimbursement or payment of legal costs***) of the funder for the scheme as a portion of the total money obtained as remedies for one or more persons as a result of a judgment made, or settlement approved, by the Court in relation to the proceedings; and
> (ii) requiring one or more persons who obtain such a remedy, but who are not general members of the scheme, to contribute to the funder's remuneration ***fixed under (i)***."

"Claim proceeds"

19. As noted above, at [1.28], the Explanatory Materials state:

> *"Litigation funders cannot enforce the claims proceeds distribution method if, in the relevant class action, the Court makes an order to impose the funder's fee or commission on claimants who are not members of the class action litigation funding scheme (a common fund order).* ***Such orders do not include orders that ensure all claimants (including those who are not members of the class action litigation funding scheme) contribute to the legal costs of the proceeding***." (Our emphasis)

20. At [1.40] the Explanatory Materials further state:

> *"The gross amount obtained as a remedy by the general members of the scheme are referred to in the schedule as the claims proceeds. Claim proceeds are intended to be* ***only the amount obtained as a remedy to the substantive claims advanced in the proceeding and not any other money obtained during the proceedings, such as an order for the other side to pay costs****."* (Our emphasis)

21. LCM submits that the drafting of the "claim proceeds" definition lacks clarity and could be interpreted as contradicting the above Explanatory Materials.

22. Therefore, LCM submits that the definition ought to be amended as follows:

> *"claim proceeds, for a class action litigation funding scheme, means the total money obtained as* ***substantive*** *remedies for one or more of the scheme's general members, as*

a result of a judgment made, or settlement approved, by a Court in relation to class action proceedings for the scheme.

Note: This is referring to the total (gross) money obtained for the scheme's general members before any reductions for the costs for the proceedings, ***but does not include any money paid towards legal costs by a defendant or another party that is not a general member****."*

23. In further support for this necessary change, LCM submits that it is unreasonable for the portion of a recovery that relates to a reimbursement of costs to be paid to general members as part of any guaranteed minimum. General members did not meet that cost, and it defies logic for them to benefit from its reimbursement.

24. By way of an example:

    24.1. A funder incurs costs of $5 over the life of an action; and

    24.2. The ultimate recovery is $10, including a reimbursement of the $5 in costs;

    24.3. LCM submits that it is unreasonable for the rebuttable presumption to be that the class members receive 70% of the $10 total without reference to the fact that $5 of that settlement are a cost repayment;

    24.4. If class members do receive $7 in this scenario, the funder would not only make no return on its $5 investment, but would in effect be paying $2 to the class members at its own expense, despite having already supported the class action to its conclusion.

"Legal costs"

25. At [1.46], the Explanatory Materials state:

    "Generally, litigation funding agreements provide for the upfront payment of all legal costs associated with a class action by the litigation funder, and the assumption of liability to pay costs for the other side." (Our emphasis)

26. The proposed definition of "legal costs" (see paragraph 31.1 below) appears to proceed on an incorrect interpretation of the above statement and the true operation of class action funding arrangements.

27. Firstly, the above acknowledges that although it is "generally" the case that the funder meets "all" legal costs, this is not <u>always</u> the case. For example, LCM submits that it is increasing common for legal firms to incur fees in relation to a proceeding on a speculative basis, with those fees being paid out of a successful recovery.

28. Secondly, it is not correct to say that the costs are incurred by the funder – they are incurred by the claimants, with the funder agreeing to pay them on the claimants' behalf under the terms of the funding agreement.

29. Finally, LCM highlights that the legal costs incurred by the claimants in a case are often a function of the tactics employed by the defendant in that action. Therefore, one set of costs ought not be considered in isolation from the other.

30. LCM submits that it is a contradiction to say that it is always in the best interests of class members to minimise costs. By way of illustration, if claimants are facing a defendant on a 'take no prisoners' mission, inappropriately minimising their costs will only leave them under-resourced, under-represented and fighting with one hand tied behind their back.

31. LCM therefore submits that:

    31.1. The definition of "legal costs" must be amended as follows:

    "legal costs, for class action proceedings for a class action litigation funding scheme, means the legal costs (including any disbursements) incurred ~~***by the funder for the scheme***~~ *in relation to the proceedings"*; and

    31.2. The "fair and reasonable" factors set out in section 601LG(3)(a) must be amended as follows:

    "(a) in relation to the proceedings, the following:
    (i) the amount, or expected amount, of claim proceeds for the scheme;
    (ii) the legal costs for the proceedings ~~***incurred by the funder***~~ *and the extent to which those legal costs are reasonable;*
    *(iii) whether the proceedings have been managed in the best interests of the general members****, including*** *to* ***appropriately*** *minimise the* ***general members'*** *legal costs for the proceedings;*
    (iv) the complexity and duration of the proceedings;"

Responsible entity costs

32. It is the obvious intention of the Exposure Draft that litigation funders are able to receive a profit or commission in funded class actions, so long as it is approved under section 601LG (or under State powers that are "substantially similar").

33. However, LCM also notes that the funder of the scheme and the scheme's Responsible Entity ("RE") may be the same and/or related entities.

34. Therefore, in this context, LCM suggests that the proposed section 601GA(5)(e) requires added clarity as follows:

    "(e) the scheme's constitution must provide that ***in respect of its services in managing the scheme as responsible entity****, the scheme's responsible entity must not be paid any amount in relation to the scheme that is greater than the entity's reasonable costs for managing the scheme"*

Transitional provisions

35. LCM submits that in certain circumstances the Exposure Draft's transitional provisions are completely unworkable.

36. In particular, the provisions are said to apply to "a funding agreement". In this regard, LCM notes that:

36.1. "Funding agreement" is relevantly defined as an agreement mentioned in paragraph 9AAA(d) as follows:

*"a person (the funder) provides funds or indemnities, or both, under an agreement (the **funding agreement**) (including an agreement under which no fee is payable to the funder or lawyers if the scheme is not successful in seeking remedies) to enable the claimants to seek remedies"*

36.2. Although it is not clear from the above, it appears that it is possible for any given class action litigation funding scheme to have more than one funding agreement, such that each agreement executed by each claimant is a separate "funding agreement" as defined;

36.3. The proposed section 1688(a) states that the relevant amendments apply to a "**funding agreement**" that "**is entered into on or after** (their) commencement" (our emphasis);

36.4. In light of the above, the drafting of the transitional provisions creates an impossible situation where one class action litigation funding scheme could have two sets of funding agreements: ones to which the relevant *Corporations Act 2001* (Cth) (the "Act") amendments do apply, and ones to which they do not; ones that have a constitution complying with proposed section 601GA(5), and ones that do not.

37. LCM submits that the transitional provisions therefore must be amended, and suggests that they ought to mirror the transitional provisions of the *Corporations Amendment (Litigation Funding) Regulations 2020* (Cth) as follows:

"The amendments made by Schedule 1 to the Treasury Laws Amendment (Measures for Consultation) Act 2021 apply in relation to class action litigation funding schemes entered into after on or after the commencement of that Schedule."

PART D: DEFINITION OF MANAGED INVESTMENT SCHEME

38. LCM has long supported fit-for-purpose regulation of the litigation funding industry. However, LCM submits that class action litigation funding schemes remain unsuitable to the MIS regime.

39. The overall legislative purpose of the regulation of MIS is to regulate closely the operation of a scheme whereby members may otherwise be at risk of losing the capital which they have invested and surrendered day to day control of, including to regulate the ability of members to achieve a ready exit from the scheme. That purpose plainly

does not cohere with inclusion of a funded class action in the definition of an MIS, in circumstances where:

39.1. There already exists a statutory regime regulating the conduct of a class action in the best interests of group members, including through the supervisory role of the Court;[1]

39.2. Group members in a class action do not place capital at risk in the same way as usually occurs in an MIS; and

39.3. The statutory regime already provides for the circumstances in which a group member may withdraw from a class action through the exercise of opt out rights.

40. These considerations tell strongly against the inclusion of a funded class action within the definition of an MIS.

41. The difficulties in applying Chapter 5C to litigation funding schemes are not merely around the edges. They go to the heart of the Chapter 5C regime. In particular, it is unclear:

41.1. Who is to be the RE of the scheme or who is required to "operate" the scheme under section 601FB(1) of the Act, this being a central objective of the changes made by the *Managed Investments Act*. The funder is not a good candidate, as the funder typically (and in the present case) does not have day to day control over the litigation, that being reposed in the representative applicant's ability to give instructions to the lawyers. The lawyers are not a good candidate either and in any event are prohibited from operating an MIS.[2] Even ASIC appears to be uncertain as to who the RE of a litigation funding scheme should be and whether or not litigation funders could be the RE consistent with the obligations of an RE under the Act[3];

41.2. If it is the litigation funder who is to be the RE of the scheme, how the litigation funder could comply with the central obligation in section 601FC(1)(c) of the Act for the RE of an MIS to act in the best interests of the members of the MIS and, if there is a conflict between its own interests and the members' interests, to give priority to the members' interests; that is, to act as a fiduciary. If the funder is taken to be the RE, this requirement would appear, for example, to restrain the funder from exercising its contractual rights in its own interests to withdraw from funding proceedings in respect of which it had become clear that the proceedings lacked sufficient prospects of recovery, or were otherwise uneconomic. To impose a fiduciary duty on a funder as the RE of a litigation funding scheme would be particularly inapposite given that in a litigation funding scheme, it is only the funder who has placed its capital on risk, and where the funder will have fiduciary duties to its shareholders and investors which might conflict with those of members. It is also inconsistent with Court practice in relation to class actions, which acknowledges that funder and member interests may diverge, for example in settlement approval proceedings during which payment of the funder's commission from a recovery is approved;

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[1] *Wigmans v AMP Ltd* (2021) 388 ALR 272; [2021] HCA 7 at [82] (Gageler, Gordon and Edelman JJ).

[2] See eg *Legal Profession Uniform Law* (NSW) s 258(1).

[3] See ASIC's submission to the Parliamentary Joint Commission inquiry into litigation funding and the regulation of the class action industry dated June 2020.

41.3. How scheme property, being at least (*ex hypothesi*) the contractual promises of members to pay certain sums to the funder from any resolution sum,[4] is to be held on trust for members of the scheme by the RE as required by section 601FC(2) of the Act;

41.4. Further, it seems on the *Brookfield FC* approach, that the "scheme property" necessarily includes *all* promises made by the group members and *all* promises from the funder; and further that the "members" of the Scheme who benefit from the use of the scheme property include not just all group members but also the funder. There would be a total disjunct in applying these notions of scheme property and trust to a funded litigation arrangement.

42. Applying the MIS definition to class actions will also cause further inconvenience and mischief which includes:

42.1. Section 601FC(1)(d) of the Act requires the RE of an MIS to treat members who hold interests of the same class equally. There is a concern, recorded in a recent ASIC Consultation Paper, that this might require a resolution sum to be distributed equally in dollar terms among group members, notwithstanding that group members' claim sizes may differ. It is also unclear how this might affect the negotiation of settlement where one subset of the group may have stronger claims than another;

42.2. ASIC requirements in relation to solvency, net tangible assets and the like are being imposed in respect of REs of litigation funding schemes. This has led funders to enter into a custodian arrangements with professional trustees to hold "scheme property" in respect of any future registered MIS. ASIC has required this as a condition of an Australian Financial Services Licence ("AFSL") permitting the operation of a litigation funding scheme. It is not clear what the custodian would actually do in practical terms as custodian to "hold" scheme property or indeed how extensive that scheme property is;

42.3. The MIS regime gives group members a statutory right to call a members' meeting and receive statements of resolutions to be moved on. The requirement that any special or extraordinary resolution put to vote at such a meeting be decided by a poll, with member allocation of votes determined by the value of their interest in the MIS also cannot practically be complied with in light of the nature of the scheme property in a class action litigation funding scheme; and

42.4. Issuing interests in an MIS triggers requirements under the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* (Cth), requiring the RE to take steps which serve no practical purpose in the context of a litigation funding scheme.

43. Further, aspects of the MIS regime in the Act overlap with, and create a real potential for conflict with, the Court's supervisory jurisdiction under Part IVA of the FCA Act. In particular:

43.1. Sections 601KA to 601KE prevent members of an MIS from withdrawing from the MIS other than in accordance with those provisions (which vary depending upon the liquidity of the scheme). By contrast, group members have an

[4] "Scheme property" is defined in s 9 of the Act relevantly to include "*contributions of money or money's worth to the scheme*".

unqualified right to opt out of a class action prior to the date fixed for opt out, under section 33J of the FCA Act. ASIC has presently provided relief in relation to this;

43.2. The requirement under section 1012B of the Act for a Product Disclosure Statement ("PDS") to be issued to prospective members of a scheme means that scheme members will receive the kind of detailed information about contemplated class action proceedings that would ordinarily be included in group member notices, without that information being disseminated under Court supervision;

43.3. A PDS is required to contain information that would, if disseminated publicly, confer a tactical advantage on the respondent to a potential class action, including as to budgeting. By contrast, rules of Court typically allow such information to be redacted from the copy of the funding agreement served upon a class action respondent. ASIC has presently provided relief in relation to this requirement.

44. The overall picture is that there are a significant number of important aspects of the substantive regime governing the MIS in the Act which at best produce no discernible benefit to group members and at worst are impossible or impractical to comply with.

PART E: GUARANTEED CLASS MEMBER RETURNS

45. Annexure A to this submission is an extract from LCM's submission to the Treasury and Attorney-General's Department Consultation Paper "Guaranteeing a minimum return of class action proceeds to class members", wherein LCM addresses the impetus for, and effect of, introducing a guaranteed minimum return to class members.

46. LCM restates this submission and its conclusion that:

"Guaranteed minimum returns for class members are a wolf in sheep's clothing. On their face, they appear to offer a group member added protection, while in reality they remove that group member's very ability to seek redress for the wrong that they have suffered".

47. LCM further reiterates its submission that the Government ought to engage in a disciplined consideration of whether this change is necessary and appropriate before proceeding to implement it.

48. LCM was not a lone voice for the above proposition. By way of one example, LCM notes that the Law Council of Australia also submitted that (at [3]):

"Given the circumstances in which the proposed reform was developed, the Law Council considers that the Australian Government should conduct a thorough investigation into the fundamental issues underlying the proposed reform before considering its implementation. Consideration is required as to the risks and practical difficulties of implementing the proposed reform, particularly in comparison to alternative options"

49. LCM would be surprised if the bulk of other submissions made did not also echo the above sentiment. However, it is presently impossible to test this, because:

    49.1. The submissions that have been made in respect of the above consultation have not been made public; and

    49.2. No public report has been released on the consultation's findings.

50. Rather, the Australian Government has proceeded to prepare the Exposure Draft and offer the industry less than four business days to respond to it.

51. LCM submits that this approach is reckless at best and is particularly egregious in circumstances where a disciplined analysis of the proposal would make it clear that this change will undoubtedly prevent hundreds of thousands of Australians from seeking redress for wrongs that have affected them.

PART F: BROADER DETRIMENT

52. LCM further submits that the Exposure Draft, if implemented, will cause considerable broader detriment, including:

    52.1. Curtailing 'open' class actions and converting class actions into an 'opt-in' model;

    52.2. Fettering judicial discretion; and

    52.3. Setting a precedent for Australian financial products and investment schemes.

53. LCM briefly addresses each of these issues below.

Curtailing 'open' class actions and converting to 'opt-in' model

54. From its inception, the class action regime in Australia has operated on an 'opt-out' basis, whereby all potential claimants who fall within the definition of the class become members of the class on the filing of the claim, whether they are aware of it or not.

55. In enacting the class action regime, the Government determined that an open class system with an 'opt-out' procedure was preferable on the grounds of equity, as well as efficiency. The then Attorney-General said:

> *"It ensures that people, particularly those who are poor or less educated, can obtain redress where they may be unable to take the positive step of having themselves included in the proceeding*"[5]

56. Contrary to the above, the Exposure Draft and Explanatory Materials make it plain that a key intention of the Bill is that claimants must consent to become members to a class action litigation funding scheme and sign a funding agreement. The requirement for this positive action shifts class actions from an 'opt-out', to an 'opt-in' model.

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[5] Commonwealth, Parliamentary Debates, House of Representatives, 14 November 1991, 3174-3175 (Michael Duffy, Attorney-General)

57. This change reverses the approach to class member participation that has been a cornerstone of Australian class actions since its inception, which will have far-reaching consequences and will negatively impact fair and equitable outcomes for plaintiffs.

58. Further, a natural consequence of this approach is that funders will proceed to book-build and will seek to commence all claims on a 'closed' basis. As the Parliamentary Joint Committee on Corporations and Financial Services Report into "Litigation Funding and the Regulation of the Class Action Industry" ("PJC") noted at [9.34] "until common fund orders were endorsed in 2016, Australia's class action regime featured a larger number of closed class actions …".

59. The above is, in part, because open class actions will become unworkable. If a funder is only able to seek a return from a party that has engaged in the MIS, in an open class action all non-MIS class members would be 'free riders' at the expense of the MIS class members, who would have to carry the full load of the legal and funding costs incurred in the claim. Since an MIS is to be operated for the benefit of its members, an 'open' proceeding with known 'free riders' would not be in the best interests of the scheme's members.

60. The move towards 'closed' class claims will increase the risk of multiple class actions being run in one court or across different courts against the same defendant. This may have the effect of increasing defendant costs, as they may need to face multiple closed claims/different schemes instead of one 'open' claim. Defendants will also never have certainty nor finality in resolving any one 'closed' class action, as that resolution would not prevent another 'closed' claim being commenced in relation to the same set of facts.

61. In direct opposition to the proposed amendments, the Australian Law Reform Commission[6] had recommended that:

> *"Part IVA of the* Federal Court of Australia Act 1976 *(Cth) should be amended to provide the Court with an express statutory power to make common fund orders on the application of the plaintiff or the Court's own motion".*

62. Further, as noted by the PJC (at 9.111]):

> *"Open class actions are a key tenet of the federal class action system that enables a common binding decision for all with common claims without a requirement to take positive steps for participation, thereby increasing the efficiency of the administration of justice. In this regard, open class actions promote certainty and finality of outcome for defendants from a settlement or judgment as all common claims are resolved, subject to those of individuals who have actively taken the step to opt out"*

63. LCM submits that the Exposure Draft seeking to force all class actions into a 'closed' and 'opt-in' model is a short-sighted attempt to make representative proceedings more suitable to the MIS regime, despite the significant negative consequences it otherwise causes for both a) future Australians wishing to seek redress, and b) future defendants to class action claims.

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[6]"Australian Law Reform Commission report, Integrity, Fairness and Efficiency—An Inquiry into Class Action Proceedings and Third-Party Litigation Funders" (ALRC Report 134), Recommendation 3

Judicial discretion

64. LCM submits that the present wording of the Exposure Draft unacceptably fetters the Courts' discretion[7] and interferes with the Courts' overarching purpose of facilitating the just resolution of disputes according to law as quickly, inexpensively and efficiently as possible[8].

65. In particular, LCM notes that proposed section 601LG(3) states that:

> *"... in considering whether the funding agreement's claim proceeds distribution method, or any variation of that method,* ***is fair and reasonable*** *when considering the interests of the scheme's general members as a whole, the Court* ***must only*** *have regard to the following factors...."*(Our emphasis)

66. There is well-developed jurisprudence in relation to the Court's exercise of its supervisory power in the context of class action settlement approvals and distributions. The Courts have been active in considering and developing criteria for approving, and ultimately modifying and setting, funding commissions in class actions. They have repeatedly considered and confirmed that commissions ought to be "fair and reasonable".

67. In the circumstances, LCM submits that it is entirely inappropriate for the Bill to limit the factors that the Court is able to take into account when considering fairness and reasonableness. The concept of fairness cannot be decided with a hand over one eye. The Court must have all relevant circumstances before it.

68. Consequently LCM submits that section 601LG(3) must be amended to ***replace "must only" with "may" or, at a minimum, "must"***.

69. Further, proposed section 601LG(4) states that:

> *"Regulations made for the purposes of this subsection may provide that this section applies as if subsection (3) were omitted, modified or varied as specified in the regulations."*

70. LCM submits that it is again entirely inappropriate for this Bill to open the door for Government to subsequently interfere with judicial discretion by way of Regulation.

71. LCM submits that proposed section 601LG(4) must be ***deleted***.

Precedent for Australian investments

72. Finally, LCM submits that the introduction of a "rebuttable presumption" that participants in an investment scheme are to receive a fixed return puts class action litigation funding schemes into stark contrast with every other financial product and managed investment scheme in Australia, none of which have ever been placed in the untenable position of having to guarantee a return to its stakeholders regardless of the circumstances of the underlying investment.

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[7]By analogy, in *Nicholas v The Queen* (1998) 193 CLR 173 at 188 Brennan CJ found that *"A law that purports to direct the manner in which the judicial power should be exercised is constitutionally invalid."*

[8] For example, sections 37M and 37N of the *Federal Court of Australia Act* 1976 (Cth) and Part 7 of the Central Practice Note (CPN-1); Section 7 of the *Civil Procedure Act* 2010 (Vic)

73. Noting that the number of Australians that have lost money in investment schemes well outweighs that of class actions, will the Government now look to fix minimum returns on other MIS products?

PART G: CONSULTATION PROCESS

74. LCM reiterates that any further changes to Australia's litigation funding industry and class actions regime must be carefully considered and structured, with the benefit of genuine industry consultation. As one of the Australia's most experienced funders, LCM believes it is well placed to assist and would appreciate the opportunity to work with the Government to successfully achieve the stated objective of "delivering reasonable, proportionate and fair access to justice in the best interests of class members".

ANNEXURE A: Extract from LCM Submission to Treasury and Attorney-General's Department Consultation Paper "Guaranteeing a Minimum Return of Class Action Proceeds to Class Members"

Impetus for guaranteed returns to group members

75. The Consultation Paper seeks to "consult on the best way to guarantee a statutory minimum return of gross proceeds of a class action to class members".

76. In seeking to identify the 'best way' to guarantee minimum returns, the Consultation Paper appears to proceed from a foundation that the Australian legal system 'should' provide such a guarantee, with the only remaining question being 'how' to do so.

77. This foundation is presumed to be supported by the PJC Report. However, this presumption calls for closer scrutiny. In considering the concept of guaranteed minimum returns, the PJC stated (at [13.61] of the PJC Report):

"An alternative suggestion that has arisen late in the inquiry is for a guarantee that class action members receive a statutory minimum percentage of the gross litigation funding proceeds."

78. The only consideration or analysis that this late 'suggestion' then receives is the PJC's sole comment that "the committee notes that this proposal focuses on protecting the class action members and maintaining access to justice". However, this comment is not considered in any further detail, not supported by any evidence, not reviewed by any relevant experts, not compared with any alternative options, nor scrutinised in any way whatsoever.

79. There is no review of whether this suggestion is appropriate, fit for purpose or actually "protecting the class action members and maintaining access to justice" as asserted. No consideration is given to whether it would assist in striving for the objective fixed by the PJC for class actions, being to "deliver reasonable, proportionate and fair access to justice in the best interests of class members" [9].

80. Further, the genesis of the 'alternative suggestion' is not a submission that was made to the PJC, nor a testimony that was heard by it. It is a newspaper article[10].

81. The only source for anything like the 'alternative suggestion' in the referenced article is the following:

"One Nation Leader Pauline Hanson has proposed a compromise that would see class actions exempted from the MIS regime if the funder committed to give at least 70 per cent of any damages award to class members"

82. However, the above compromise is not what is now being considered by the Consultation Paper. The Consultation Paper does not refer to any exemption from the MIS regime. It is asking how to guarantee a statutory minimum return of gross proceeds to <u>all</u> class members.

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[9] PJC Report at [5.7]

[10] See footnote 65, Chapter 13 of PJC Report; Ronald Mizen, *Litigation funding rules on the brink as dissent grows*, 11 November 2020.

83. In light of the above:

83.1. LCM submits that no cogent, evidence-based consideration has been given (at least not publicly) to the question of 'whether' guaranteed minimum returns are, on the whole, going to protect or benefit current and potential future class action group members, or maintain access to justice;

83.2. As discussed below, it is LCM's submission that if a disciplined analysis were undertaken, it would make clear that such a change, if effected, will undoubtedly prevent hundreds of thousands of Australians from seeking redress for wrongs that have affected them; and

83.3. Consequently, LCM submits that the consultation process commenced by the Consultation Paper cannot, and ought not, proceed as a blinkered review of 'how' minimum returns ought to be implemented. Rather, the consultation process must first genuinely engage with the question of 'whether' such a guarantee is necessary and appropriate.

Are guaranteed minimum returns to class members necessary and appropriate?

84. The PJC Report notes that (at [5.4]-[5.5]):

"… in evidence to the inquiry, no one disputed the important role of class actions in Australia's civil justice system… the committee concurs with the findings of numerous previous reviews: namely, that class actions, when working as originally intended, should facilitate access to justice, discourage wrongdoing, and promote the efficient and effective use of court resources.

… litigation funders enable individuals to pay for the high costs of accessing the civil justice system in Australia. In particular, the nature of Australia's adverse costs regime means that the unsuccessful party to civil proceedings pays for their own legal costs as well as those of the successful party. Therefore, as evidence to the inquiry demonstrated, litigation funders play a vital role in effectively filling the funding gap that would otherwise exist because no ordinary Australian or group of Australians could afford to be exposed to the risk of an adverse costs order in the event that a class action did not succeed. As litigation funders effectively cover that risk, the committee recognises that, in many instances, a class action could not proceed in Australia without a litigation funder."

85. By reference to Professor Morabito's "*An Evidence-Based Approach to Class Action Reform in Australia*", LCM notes that before the end of 2018, gross recoveries in funded class actions exceeded $2.1billion. Since that time, this figure has considerably increased.

86. There is no doubt that, on the whole, litigation funders have greatly assisted class members to achieve redress and recoveries through funded class actions.

87. So, is there a need for change?

Class members

88. The critics of class action returns to class members almost exclusively focus on how successful recoveries have been distributed. Criticism is levelled at funders (and lawyers) for taking too big a piece of the pie in certain well-worn examples.

89. However, these criticisms rarely pause to consider how the pie was created in the first place.

90. It is trite to say that class actions are pieces of litigation, but this simple point is consistently overlooked. Class actions are large-scale complex litigation, and this litigation is adversarial, it is risky and it is expensive. LCM submits that it cannot be forgotten that by participating in a class action, this is the process that class members are embarking upon. They are not simply applying for compensation through a scheme whereby the payment of such compensation is a certainty, far from it.

91. Litigation is inherently unpredictable – an action is commenced with imperfect information, progressed through an adversarial process and adjudicated by a member of the judiciary. The risk of a complete loss or an unsatisfactory outcome is an unfortunate aspect of litigation reality, and the cost of advancing a claim, particularly against a combative defendant, can have a very significant impact on an action's ultimate proceeds. This is true of both funded and unfunded proceedings, both commercial claims and class actions.

92. Further, the concept of a guaranteed minimum return for class members effectively assumes that a class action can only have two outcomes: total success or total loss, and that if total success is achieved, the guaranteed minimum share of that success should be reserved for class members. This does not reflect the reality of the litigation process. For example, a class action which at the outset appears to have good prospects of success, may see those prospects deteriorate once evidence is exchanged; a class action which appears to be targeting a corporate with significant funds, may ultimately find that the defendant has little capacity to pay the amount being sought. In such circumstances, it is in the interests of the class to avoid total loss by a compromised outcome that reflects the change in the risk profile of the action. Such compromised outcomes are a feature of all litigation. However, these scenarios are not properly accounted for in the consideration of guaranteed returns.

93. Never in the history of litigation have lawyers, barristers, experts, legislators or Courts guaranteed to any plaintiff that they will receive a particular minimum return from pursuing their claim. LCM submits that there is no clear basis for proposing to treat plaintiffs differently now, solely because they are in a funded class.

94. LCM further notes that due to the Court's supervisory role in all class actions, before the Court approves any settlement or distribution in a claim, it first conducts a detailed review of all the circumstances, including objections from any class members dissatisfied with the resolution, advice from senior counsel as to why the settlement is fair and reasonable and, increasingly, reports from costs assessors (often Court appointed) as to whether the legal costs incurred were appropriate. Courts also often offer class members an opportunity to opt out of the settlement if they were not satisfied with it, and Courts do decline to approve settlements if not satisfied that they are reasonable[11].

95. Therefore, in respect of each past class action settlement approval and distribution, a Court was satisfied that a) the resolution amount was reasonable in light of the claim's prospects and risks, b) the payable costs were reasonable, c) the payable funding

[11] See for example *Endeavour River Pty Ltd v MG Responsible Entity Limited* [2019] FCA 1719; *Bywater v Appco Group Australia Pty Ltd* [2020] FCA 1537

commission was reasonable, and d) the settlement distribution scheme was fair and reasonable as between the group members.

96. In light of the above, the only sensible inference that can be drawn from all concluded cases is that the participating class members incurred reasonable costs in progressing their class action, achieved a reasonable outcome in the circumstances, and were more satisfied with accepting that outcome than not accepting it (i.e. they did not opt out).

97. The above inference, in LCM's submission, ought to alone be enough to give this consultation process pause to consider whether any change is actually justifiable in the name of group members.

98. It is further important to note that class members are not entirely passive action participants. Class members are often required to register their interest in joining the claim and, importantly, many of them take the positive step of entering into a written funding agreement with the funder. LCM submits that this segment of class members (which often includes sophisticated investors, institutional investors, Councils, businesses etc) cannot be overlooked in the consideration of the proposed guarantee. The right of these parties to freely enter into a commercial arrangement to finance the pursuit of their legal claim cannot be restricted and the effect of such contracts should not be overridden by statute. This is particularly so following the introduction of AFSL and MIS requirements into class actions, which ensure that detailed disclosure is given to class members. A statutory minimum guarantee sits uncomfortably with the MIS regime as it has the potential to result in a departure from the terms of the investment which class members have chosen to participate in.

Funders

99. As noted above, the critics of class action returns to class members often overlook the multifaceted process by which the recovery was realised. This includes a failure to appreciate the process by which funders select and approve claims for funding.

100. At the outset, LCM does not suggest that the funder's perspective is important because the consultation process ought to protect funding businesses or their profits. Rather, LCM seeks to stress that funders are selective about the claims that they fund and funders' appetites for supporting class actions are not inelastic. Funders do not have to fund class actions, and if class action regulation is changed in a way that shifts the balance between risk and return beyond acceptable limits, funders simply will not continue to fund these claims and will instead continue to increase their investments in other claim types such as insolvency, arbitration and commercial litigation (for which there is a developed litigation funding market in both Australia and globally).

101. Below, LCM seeks to demonstrate the dramatic effect that any guaranteed minimum return to class members will have on a funder's ability to fund future actions, particularly if that guaranteed threshold is fixed at 70%.

102. To do so, LCM first reiterates that the risk profile of funded class action claims is unlike that of any other investment class:

    102.1. Before any recovery can be generated, every action is investigated, prepared, commenced, tenaciously prosecuted for many years, and consistently funded despite relentless parry tactics of well-funded defendants and skilled defendant legal teams. The cost of doing so is not often less than $5million. It is often more than $10million;

102.2. It is the funder who outlays all costs and carries the risk that they will not be reimbursed (and, worse, that adverse costs will also need to be met) for the entire life of the action; and

102.3. There is no certainty of a return until a claim is finally resolved. There is no guarantee of a settlement and class actions do lose[12].

103. Funding class action litigation is a highly specialised, costly, high risk and almost entirely illiquid endeavour. It is in this context that funders make decisions as to whether to agree to fund a proceeding.

Funding decisions

104. Funders do not fund every claim. By way of example, LCM provides funding to only between 3% and 7% of the applications it receives.

105. LCM, and most other reputable funders, have fixed criteria when deciding whether the claim is suitable for funding. LCM's criteria can be found at https://www.lcmfinance.com/working-with-lcm/lcms-funding-criteria/.

106. When considering a claim, one of the key matters that funders carefully review is the 'proportionality' between the budgeted investment sum and the likely recovery. Reputable funders do not accept matters for funding if it is not clear that the size of the claim is sufficient to allow for a) the legal spend anticipated, b) the funding commission, c) the bulk of the recovery being paid to the claimants and d) a "buffer" to allow for settlement discounts, increases in costs and potential reductions in claim value as the claim develops.

107. In light of the above, the use of a predetermined minimum for class member returns has a direct impact on the size of the claim that the funder is able to accept as sufficiently 'proportionate' to meet its funding criteria.

108. The following is a reverse-engineered demonstration of a 'proportionality' analysis in the context of a guaranteed 70% return to class members:

108.1. By way of example, the costs of a class action are estimated to be $1million;

108.2. Due to the risk profile set out at 102above, common pricing structures would see funders aiming for a return on invested capital ("ROIC") of 3x. The funder would therefore seek to allow for a $3million commission in its calculations;

108.3. In order for class members to recover the guaranteed minimum of 70% in this claim, the aggregate of the above costs and commission would need to represent no more than 30% of the claim's recovery. The total minimum recovery would therefore need to be more than $13.3million:

[($1m costs + $3m commission) / 30% x 100%] = $13.3m]

108.4. However, claims do not usually resolve for 100% of their formulated claim value. Therefore, the funder may allow for a settlement/litigation risk discount. Depending on the claim, a prudent and conservative funder approaching the claim in its infancy could estimate this to be up to 50%. Therefore, in order to

[12] For example, *Crowley v Worley Limited* [2020] FCA 1522; *TPT Patrol Pty Ltd as trustee for Amies Superannuation Fund v Myer Holdings Limited* [2019] FCA 1747.

achieve a recovery of $13.3million, the claim size would need to be over $25million:

[$13.3m / 50% x 100% = $26.6m]

108.5. The above analysis shows that with a budget of $1million and a guaranteed minimum return to class members of 70%, claims with a quantum below $25million would not meet reputable funders' 'proportionality' criteria and would not be funded.

109. Applying the same analysis to more realistic class action budget figures arrives at the following claim size parameters:

Budget	Minimum claim size
$4,000,000	$100,000,000
$5,000,000	$125,000,000
$10,000,000	$250,000,000
$15,000,000	$375,000,000

110. The above shows how two integers, being a) the budget, and b) a guaranteed minimum percentage return to group members (neither of which a funder has control over), can directly fix significant barriers to the size of claim that can be funded.

111. Since costs are relatively inflexible for class actions, the above is a clear indication of the class action sizes that the proposed guarantee of minimum returns will render 'un-fundable'. Put another way, if the guarantee were to be introduced, class actions that are smaller than the minimums noted above simply will not be able to obtain funding from reputable funders.

112. Conversely, in the event that the class members seek to limit the budget in order to retain sufficient 'proportionality' to obtain funding, they place themselves at a great tactical disadvantage against well-heeled defendants represented by top-tier legal teams.

113. To further clarify:

113.1. Reputable funders do aim for the bulk of a recovery to be paid to class members. Claims are not funded if this criterion is not met, not only because of funders' policy views, but also because the failure to deliver the bulk of a settlement to class members creates a genuine risk that a proposed settlement or distribution will not be Court approved.

113.2. However, a statutory guarantee of minimum returns to class members creates a fixed risk that the funder will not achieve a sufficient return in the claim, regardless of the circumstances. If the funder is unable to price for this additional risk, it creates a widening of the 'proportionality' analysis and a real disincentive for funding that claim.

Evidence

114. By reference to Professor Vince Morabito's data helpfully assembled in "*Post-Money Max Settlements in Funded Part IVA Proceedings*" (December 2020), LCM has prepared Annexure A to this submission, being an analysis of settlements in recent

funded class actions and how those claims would be approached by funders if a 70% group member return guarantee were applied to them.

115. Annexure A shows that:

115.1. For the actual concluded class action settlements:

115.1.1. Funders' commissions have averaged 24% of gross recoveries.

115.1.2. Funder ROIC[13] has averaged in the order of 1.39x. It is important to note that this ROIC of 1.39x is what has been achieved on successful claims, and is not inclusive of losses (it is also far lower than the 3x which funders may aim for at the outset of an investment).

115.1.3. Conservatively assuming that an average class action takes three years to resolve, the above ROIC translates to average annual returns of 46%.

115.2. In the event that the same class actions were to guarantee a minimum 70% return to class members:

115.2.1. Funders' average commissions would decrease to 8% of gross recoveries.

115.2.2. Funders' average ROIC would decrease to 0.72.

115.2.3. Average annual returns would decrease to 24%.

115.2.4. Out of the 35 class action settlements considered, the funder would have achieved a ROIC of over 3x in one claim (2.85%) and a ROIC of over 2x in four claims (11.4%).

116. Further, as summarised by PWC in their "*Models for the Regulation of Returns to Litigation Funders*" Report (p 14):

"The foreshadowed cap of 30% [in funder commissions] *would have had implications for 91% of publicly available settlements funded under Part IVA proceedings".*

117. LCM reiterates that the above analysis is not provided in an effort to elicit tears for funder profits. Rather, it serves to clearly highlight the economic reality that guaranteed minimum returns to group members, particularly at 70%, will simply make the funding of most class actions uncommercial. And actions that are uncommercial to fund will not receive funding from reputable funders.

Summary

118. LCM does not doubt that if guaranteed minimum returns to group members were introduced, in some of the class actions that nevertheless receive funding, the returns to group members may be higher than those they would have otherwise achieved.

[13]Calculated by dividing the funder's commission by the sum of costs for that claim (assuming that the funder has invested this amount into the action)

However, LCM stresses that the number of such class actions, i.e. class actions that nevertheless receive funding, will dramatically decrease.

119. Importantly, if meritorious actions are not funded, it does not mean that they will progress as unfunded claims. LCM submits that a very small percentage of 'fundable' claims would be commenced and progress to a resolution unfunded. That small percentage would also be likely to be progressed by plaintiff firms on a contingency basis in the Supreme Court of Victoria, where the commissions such firms can charge are not capped.

120. Advocates for change refer to the (obvious) fact that group members receive a greater proportion of the settlement award in unfunded matters, comparing a 51% median in funded against an 85% median in unfunded claims[14]. LCM submits that this is not an accurate comparison. If future actions are not funded and therefore do not proceed, the comparison is not between 85% and 51% of a settlement, it is between 51% of a settlement and 100% of nothing.

121. As noted in the PJC Report (at 5.5):

"…the committee recognises that, in many instances, a class action could not proceed in Australia without a litigation funder."

122. In short, LCM submits that guaranteed minimum returns for class members are a wolf in sheep's clothing. On their face, they appear to offer a group member added protection, while in reality they remove that group member's very ability to seek redress for the wrong that they have suffered.

[14] PJC Report at 13.8; Australian Law Reform Commission, *Australian Law Reform Commission, Integrity, Fairness and Efficiency – An Inquiry into Class Actions Proceedings and Third-Party Litigation Funders,* Final Report, December 2018, p. 70.