SUBMISSION TO TREASURY

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

October 2021

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Maurice Blackburn Lawyers Since 1919

INTRODUCTION

In the ongoing policy debate surrounding changes to class action practice and procedure, there appears to be a broad consensus about the social utility of third party litigation funders in facilitating access to justice. As the majority of the Parliamentary Joint Committee recognised in its recent report, in many instances class actions would not proceed without a litigation funder paying the plaintiff's costs, providing an indemnity for adverse costs, providing security for costs and narrowing the gap in the financial resources available to plaintiffs and defendants.

There is also a consensus that a desirable goal is to reduce transaction costs in the class actions system because the consequence of that is obviously to increase the returns to group members on whose behalf the cases are pursued.

The real issue in the policy debate is how to balance these considerations, recognising that the important services provided by litigation funders do not come without cost, while at the same time seeking to ensure that group members receive a fair and reasonable return as compensation for their losses. The most efficacious means of reconciling these objectives is not to impose what is effectively a price cap on legal and funding costs, but instead to promote competition in the funding market by enacting reforms proposed by the ALRC in its report in December 2018. These include the recommendations that courts be given statutory power to make common fund orders and that lawyers be permitted to use percentage-based fee agreements in class actions.

We are concerned that aspects of the Bill do not have a sound basis in policy and will produce unjust and unprincipled outcomes.

Our primary concern relates to two related features of the Bill, namely (1) the proposed rebuttable presumption that 70% of claim proceeds must be distributed to group members and (2) the prescription of an exhaustive list of factors that would circumscribe the courts' consideration of what is a fair and reasonable return to group members and relatedly whether the rebuttal presumption should be displaced.

One of the major problems with the application of these two features of the Bill is that any court considering whether it is fair and reasonable to displace the presumption will ostensibly not be permitted to consider a critical factor that bears upon the reasonableness of returns to group members. The critical factor that is missing from section 601LG(1) is a comparison of actual returns to group members with their best case or most likely recovery. The courts' inability to consider actual returns against group members' best case recovery will result in unprincipled and capricious outcomes, and may lead to an arbitrary reallocation of claim proceeds as between group members, their lawyers and litigation funder.

We are also concerned about the rushed and inadequate processes surrounding the preparation of the Bill and the consultation process relating to it. The result of that rushed process is that there are a number of instances where the Explanatory Memorandum contains statements that are at odds with the text of the Bill itself, and it is difficult to reconcile these discrepancies and therefore understand the intended operation of the Bill. The most notable of these discrepancies relates to the ongoing availability of common fund orders if the Bill is passed. On one hand section 601LF appears expressly to contemplate common fund orders being made as an alternative to litigation funders enforcing contractual rights in order to receive payment. On the other hand, the Explanatory Memorandum contains a number of statements

that suggest an intention that common fund orders cannot be made (see paragraphs 1.6 and 1.28 in particular).

The Explanatory Memorandum also contains statements which reflect an erroneous understanding of the operation of class actions procedure, and this has permeated some aspects of the Bill. For example it is said that the purpose of the proposed requirement for claimants to agree in writing to become members of a scheme in section 601GA(5)(a) is to ensure that no one can be "co-opted" into becoming a member of a litigation funding scheme without their active consent. Again this is suggestive of a rushed process that has resulted in a proposal that is inapt and unnecessary.

This submission has been prepared by Maurice Blackburn, which has Australia's largest and most successful class actions practice, having obtained more than $3.6 billion in compensation for class members across a range of different types of class actions. More information about Maurice Blackburn's history and experience in class actions is set out in **Appendix A**.

Our submission is structured by reference to the first six (of seven) features[1] of the Bill that are said to be new laws as noted in the table in paragraph 1.28 of the Explanatory Memorandum. Finally, we note our concern that the definition of "class action litigation funding scheme" has been drafted in a way that may make it applicable to non-class action proceedings that involve a litigation funder (for example regular commercial disputes, or insolvency proceedings).

1. Litigation funding agreements must state the way that proceeds of a class action would be distributed

1.1 The proposed new section 601GA(5)(b) requires that a scheme's constitution must provide that a litigation funding agreement contains a "claim proceeds distribution method", which sets out the method by which the claim proceeds are to be distributed to members of the scheme.

1.2 As a matter of class actions practice this already occurs because unless a common fund order is made, remuneration of a litigation funder is dependent upon there being contractual arrangements between the litigation funder and members of the scheme, and the funding agreements therefore specify the payment to be made to the funder as consideration for the services that are provided by the funder. In other words, litigation funding agreements already set out a claim proceeds distribution method, most commonly by specifying a percentage of the proceeds that group members are obligated to pay to the funder.

1.3 For this reason, this aspect of the Bill is uncontroversial in principle.

1.4 However we recommend an adjustment to the wording of the definition of "claim proceeds distribution method" in order to avoid confusion or doubt about the interpretation of that term:

[1] The seventh feature in the table under paragraph 1.28 of the Explanatory Memorandum – ie jurisdictional issues, and the interaction between with common fund orders – is addressed in the context of our response to the first six features.

(a) The apparent intent of section 601GA(5)(b) is that funding agreements must specify how any claim proceeds are to be distributed as between members of the scheme on one hand, and the litigation funder on the other hand, for example by specifying that X% is to be paid to the funder, with the consequence that the remainder is to be paid to members.

(b) In our view the existing definition of "claim proceeds distribution method" could be misinterpreted to mean that litigation funding agreements must specify the method by which individual members' compensation entitlements are to be calculated or worked out if the claim is successful. It would not be appropriate for litigation funding agreements to include a method for calculating scheme members' compensation entitlements because such a method would only be known at the time that a settlement distribution scheme is approved by a court, or a court gives judgment on individual members' compensation entitlements. In addition, it is not the role of a litigation funder and would also be beyond their authority to seek to predetermine how individual compensation entitlements are to be worked out or calculated in a class action, and for this to be recorded in a litigation funding agreement.

1.5 In order to provide certainty about this issue, we recommend that the definition of claim proceeds distribution method in the proposed section 601GA(5)(b) be amended as follows, noting that the most common methods for calculating a funder's remuneration are (1) a percentage of the claim proceeds or (2) a multiple of the amount expended by the funder, or a hybrid of these two methods:

> … a method (a ***claim proceeds distribution method***) for determining the <u>proportion</u> ~~amount~~ of any claim proceeds for the scheme that is to be paid or distributed to the scheme's general members <u>or such other method by which the funder seeks to be remunerated</u>; …

2. Litigation funding agreements are only enforceable if a court approves the method of distribution or varies it

2.1 Section 601LF(1) provides that a litigation funding scheme is not enforceable and has no effect to the extent that it relates to the claim proceeds distribution method unless:

(a) the court approves or varies the claim proceeds distribution method pursuant to section 601LG; and

(b) the court does not make a common fund order.

2.2 In principle we agree with these proposed changes, noting that the Australian Law Reform Commission made recommendations to a similar effect,[2] and that during the ALRC's consultation process we supported the introduction of legislative changes that would give the courts power to reject, vary or amend the terms of litigation funding agreements.

[2] ALRC, *Integrity, Fairness and Efficiency – An Inquiry into Class Action Proceedings and Third-Party Litigation Funders: Final Report* (ALRC Report 134, December 2018) at page 10 (Recommendation 14).

2.3 There are, however, a number of comments that we make in relation to the proposed section 601LF, noting also that our comments on the fairness and reasonable test pursuant to section 601LG are in Section 3 below.

2.4 *First*, our support for the proposed power is conditioned on the ongoing availability of common fund orders. Our understanding of the terms of section 601LF is that it specifically contemplates common fund orders being made by courts. However, there are discrepancies between the terms of the Bill itself and its description in the Explanatory Memorandum. Paragraph 1.6 of the Explanatory Memorandum suggests that the intent of the Bill is to prohibit common fund orders[3] whereas section 601LF seems predicated on (and expressly refers to) the capacity of the courts to make them. Paragraph 1.28 of the Explanatory Memorandum apparently contemplates common fund orders in the first sentence, but then denies their effect in the second. That these discrepancies exist is an indication of the rushed and inadequate processes surrounding the Bill.

2.5 Common fund orders have proven to an effective way to drive down transaction costs for group members and consistently with the ALRC's recommendations, the Federal Court should be given express power to make them.

2.6 *Secondly*, there appears to be a further discrepancy between the Bill and the Explanatory Memorandum as to when the court's inquiry is to occur in the context of a class action's procedural journey:

(a) Section 601LG(2)(b) states that the approval is to occur when the proceedings are sufficiently progressed to enable the court to determine whether the claim proceeds distribution method (or any variation) is fair and reasonable. In our view the most logical time at which to assess the fairness and reasonableness of the funder's remuneration is at the time of resolution or settlement of a class action. It is only at that time that the court could meaningfully evaluate the factors required to be considered in the fairness and reasonableness test in section 601LG(3), including the amount of claim proceeds, legal costs, whether the proceedings have been managed in the best interests of group members, the complexity and duration of the proceedings, etc. Resolution or settlement is also the most logical time for the court to receive evidence from any fee assessor and/or representations by any contradictor pursuant to section 601LG(6).

(b) On the other hand the Explanatory Memorandum appears to contemplate that the approval of the claim proceeds distribution method should occur at the outset: paragraph 1.55 states that a "fair and reasonable distribution method from the beginning of the scheme would reduce costs when the court needs to determine whether the method is fair and reasonable".

[3] This is because paragraph 1.6 suggests that the court would not be able to make orders which extend the funder's fee or commission to class members who are not members of the litigation funding scheme, which is precisely what occurs when a court makes a common fund order requiring all group members in a class action to contribute to the funder's fee or commission, regardless of whether the group members entered into a funding agreement.

2.7 In order to provide clarity about when the court's inquiry should occur, the draft section 601LG(2)(b) should be amended by replacing the existing text with the following:

> the Court is determining whether to approve a proposed settlement of the proceedings, or is otherwise determining whether to make orders that will have the effect of finally resolving the claims of group members in the proceedings.

2.8 *Thirdly*, it is unclear how section 601LF(4) would survive a constitutional challenge because it seeks to regulate proceedings in a State or Territory court that is not exercising federal jurisdiction. This issue is not addressed in the Explanatory Memorandum. We also note that section 601LF(4) appears to be inconsistent with 601LG(2)(a)(ii), which omits reference to a State or Territory court that is not exercising federal jurisdiction; in other words, section 601LG(2) appears only to require an inquiry into the fairness and reasonableness of a claim proceeds distribution method if (1) the Court is a federal court or (2) the Court is a court of a State or Territory that is exercising federal jurisdiction in the proceedings.

3. Factors to be considered when approving or varying a distribution method, including the rebuttable presumption that a return of less than 70% to members is not fair and reasonable

3.1 The proposed new section 601LG:

(a) empowers a court to approve or vary a claim proceeds distribution method in a litigation funding agreement (subsection 1);

(b) sets out an exhaustive (rather than inclusive) list of factors to which the court is to have regard (subsection 3), and provides that those factors may be modified by regulations (subsection 4);

(c) establishes a rebuttable presumption that a claim proceeds distribution method is not fair and reasonable if less than 70% of the claim proceeds are to be paid or distributed to the scheme's general members (subsection 5).

3.2 Consistently with our position in relation to section 601LF as noted in Section 2 above, we support the legislative empowerment of the courts to approve or vary the claim proceeds distribution method in a litigation funding agreement.

3.3 We do not support the introduction of subsections (3) and (4), which have the effect of fettering the ability of a court to consider all factors that may be relevant in an individual case, and instead restrict the court's consideration to those factors that are specifically mentioned in subsection (3) or that may be prescribed by regulations. If the courts are to be called upon to consider whether a claim proceeds distribution method is fair and reasonable, the courts should be able to consider all relevant factors without being constrained to consider only those that are specifically prescribed.

3.4 A fundamental vice in subsections (3) and (4) is that the court would not be permitted to consider the return to class members as a proportion of their best case recovery. For example, if class members receive only 50% of gross claim proceeds and yet

receive 100% of their best case damages claim, section 601LG(3) would not allow the 100% recovery to be considered by the court in determining whether a departure from the presumed 70% return was justified. This is because section 601LG(3)(a)(i) contains an exhaustive list of factors that can be considered by the court, which only allows consideration of "the amount, or expected amount, of claim proceeds for the scheme", and not the relativity of that amount in comparison to the group's best case damages.

3.5 More detailed reasons as to why the rebuttal presumption is not appropriate are set out in **Appendix B** to this submission. In summary:

(a) There is no evidence of widespread systemic failure of the class actions regime in delivering reasonable returns to group members in cases involving litigation funders. Although there are notorious examples involving particularly poor returns to class members, those cases are the exception rather than the norm.

(b) The selection of 70% as the mandated return has not been explained or justified either in the Parliamentary Joint Committee's report or the Explanatory Memorandum. It is arbitrary and is liable to lead to unprincipled outcomes that do not advance the interests of members of a class action.

(c) The wrong denominator is being used as the benchmark against which the reasonableness of returns to class members is proposed to be assessed. Instead of using the gross resolution sum, the more important question is how returns to class members compare against their best case recovery. For example in *Evans v Davantage Group Pty Ltd (No 3)*,[4] group members received only 37.5% of the gross settlement sum, and yet they received around 100% of their best case damages.

(d) While in theory a favourable outcome for group members in comparison to their best case damages ought to justify a departure from the presumption that 70% must be distributed to class members (for example the circumstances in *Evans v Davantage* should justify such a departure), section 601LG would not allow the courts to evaluate the reasonableness of returns to class members against their best case recovery because, as noted above, section 601LG(3) restricts the factors that the courts can consider to an exhaustive list that does not include class members' best case recovery.

(e) The use of the gross settlement sum (or claim proceeds) as the benchmark for evaluating the reasonableness of returns to class members also inhibits the proper and principled consideration of the reasonableness of compromises that were made in a settlement. In fact the restricted list of factors in section 601LG(3) may circumscribe the ability of the courts to consider the overall fairness of a settlement because the factors in section 601LG(3) may conflict with other factors that the courts are required to take into account in deciding whether to approve a settlement.

[4] [2021] FCA 70.

(f) Not all settlements are structured as global "all in" settlements where a single sum is paid by the defendant, inclusive of legal and funding costs. It is unclear how section 601LG(6) would operate in circumstances that do not involve a global settlement sum. So too it is unclear how the provision would be applied if there is no settlement but, rather, the class action proceeds to judgment on the common issues and the representative plaintiff's claim but without resolving individual group members' damages claims.

3.6 In our submission the 70% guarantee should not be introduced. Instead the government should take steps to implement the ALRC's recommendations that the Federal Court should be legislatively empowered to make common fund orders (Recommendation 3) and lawyers in class actions should be able to enter into percentage-based fee agreements (Recommendation 17).

3.7 The policy rationale for these recommendations was discussed in detail in the ALRC's report and we therefore do not intend to summarise or repeat the issues in detail. However we reiterate our view that the best way to improve returns to class members is to promote competition among funders and lawyers.

3.8 In the three years between the Full Federal Court's decision in *Money Max Int Pty Ltd v QBE Insurance Group Ltd*[5] in 2016 and the High Court's decision in *BMW Australia Ltd v Brewster; Westpac Banking Corporation v Lenthall*[6] in December 2019, common fund orders had the effect of putting downward pressure on litigation funding charges largely as a result of the increased competition in the funding market. In the ALRC's report which was published in December 2018 during the middle of that three year period, it was noted that the litigation funding market in Australia included 33 litigation funders.[7] By contrast our experience before 2016 was that the funding market was limited to approximately half a dozen funders who were active in funding class actions.

3.9 The availability of percentage-based fee agreements (as recommended by the ALRC for the Federal Court, and as is now already the case in the Victorian Supreme Court[8]) will operate to increase competition in litigation funding even further, principally because it will enable law firms to compete with third party litigation funders. These measures will improve outcomes for class members far more effectively than the proposed statutory guarantee. The introduction of common fund orders and percentage-based fee agreements will of course also give the Federal Court direct control over the deductions to be made from any settlement sum.

3.10 The rebuttable presumption will have two effects:

(a) It will reduce the number and types of cases that are attractive to third party litigation funders, thereby reducing access to justice because it cannot be assumed that law firms acting on a conditional fee basis will (or will be able to) fill the gap in all such cases and thereby also dampening competition in the funding market.

[5] (2016) 245 FCR 191.
[6] [2019] HCA 45; (2019) 374 ALR 627.
[7] See Appendix G.
[8] Section 33ZDA of the *Supreme Court of Victoria Act 1986* (Vic) provides for the Court to make a "group costs order".

(b) It will deter some funders from being involved in the Australian funding market because, to put it colloquially, it simply isn't worth it due to the increased regulatory requirements and compliance costs resulting from the *Corporations Amendment (Litigation Funding) Regulations 2020* (Cth) and now compounded by the increased risks that funders' returns on investment may be at risk due to the implementation of an arbitrary and unprincipled presumption that at least 70% of claim proceeds must distributed to class members, regardless of whether a proposed settlement would provide a reasonable and fair return to class members when assessed against their best case recovery.

3.11 Neither of these outcomes is in the interests of people who have been harmed by corporate wrongdoing and whose access to redress is dependent on third parties agreeing and being able to provide finance to facilitate their efforts to obtain justice, and increased competition in the market for litigation funding to reduce the costs associated with it.

4. Litigation funding agreements must contain an undertaking from the funder that it will pay the costs of a fee assessor and contradictor

4.1 The proposed new section 601LG(6) requires that unless it is not in the interests of justice to do so in the context of considering whether to approve or vary a claim proceeds distribution method, the court must receive and consider a report from a fee assessor and it must also consider any representations made by a contradictor.

4.2 Relatedly, the proposed new section 601GA(5)(d) requires that unless the court orders otherwise, a scheme's constitution must provide that the litigation funding agreement obligates the funder to pay the reasonable costs of any fee assessor and contradictor.

4.3 For the following reasons in our view both of these new requirements should not be introduced in their current form.

4.4 *First*, in some cases it may be appropriate for a fee assessor and/or contradictor to be appointed in order to assist the court in evaluating the fairness and reasonableness of a claim proceeds distribution method, however in our view there will be many instances where it is unnecessary because the claim proceeds distribution method is uncontroversial or is ostensibly fair and reasonable. For example, if a claim proceeds distribution method proposed that 15% of the claim proceeds were to be deducted, in the ordinary course it is unlikely to be necessary for a fee assessor and contradictor to be appointed.

4.5 *Secondly*, while it is proposed that the litigation funder is to pay the reasonable costs of any fee assessor and contradictor, the practical reality is that these costs will be passed on to group members, whose compensation entitlements will therefore be diminished accordingly. This is because litigation funding agreements typically provide that in addition to the funder receiving its remuneration (for example a percentage of the claim proceeds), the funder is also to be reimbursed any costs that it expended in funding the class action, such as legal costs. The costs of any fee assessor and contradictor are likely to be treated the same way, and although the

court can dispense with the requirement to appoint both a fee assessor and a contradictor, it is likely to become the norm if these proposals are enacted.

4.6 If these provisions are to be introduced in some form, in our view the option of appointing a fee assessor and/or contradictor ought to be left to the court's discretion, rather than being mandated unless the court forms the view that it would not be in the interests of justice. This could be achieved by amending section 601LG(6) to replace the word "must" with the word "may" in the chapeau, and deleting the words "unless it is in the interests of justice to do so" at the end of the subsection.

5. Litigation funding agreements must state that the governing law of the agreement is the law of an Australian jurisdiction

5.1 The proposed new section 601GA(5)(c) requires that a scheme's constitution must provide that litigation funding agreements are to include words to the effect that the agreement is subject to the law in force in a particular State or Territory.

5.2 In order to ensure that Australian courts have jurisdiction to hear disputes about litigation funding agreements relating to class actions in Australian courts, in our view this proposal is sensible.

6. The constitution of a class action litigation funding scheme must provide that the general members are only those who have agreed to be members

6.1 The proposed new section 601GA(5)(a) requires that a scheme's constitution must provide that in order for a claimant to be a member of the scheme, the claimant is required to agree in writing to be a member of the scheme and to be bound by the scheme's constitution.

6.2 The Explanatory Memorandum states (at paragraph 1.45) that the purpose of this new requirement is to ensure that "class action members cannot be co-opted into a litigation funding scheme without their active consent". This statement reflects a muddled conception of how class membership and the opt out process operate under Australian class action procedural regimes.

6.3 This is because there is a difference between (1) being a member of a litigation funding scheme and (2) being a member of the group on whose behalf a class action is prosecuted. Although the two may overlap, they are not always the same and it is already the case that people cannot be forced to participate in a litigation funding scheme without having actively provided their consent in writing.

(a) In a "closed" class action, membership of the litigation funding scheme is identical to group membership in the class action because the class is typically defined only to include people who have entered into litigation funding agreements. In other words, in a closed class action all group members will have taken the active step of entering into a litigation funding agreement, and they will have done so in writing because the funding agreement itself is in writing.

(b) In an "open" class action, general members of a litigation funding scheme typically do not comprise all group members in the class action. This is because it is not necessary for group members to enter into litigation funding arrangements in order for them to be participants in the class action. Rather, people are automatically group members in the class action if they meet the definition of the class, and they remain group members unless and until they decide to opt out (for example pursuant to section 33J of the *Federal Court of Australia Act 1976* (Cth)). If a class action is supported by a litigation funder, group members may choose to enter into litigation funding agreements, but are not obligated to do so. In this sense, people cannot be "co-opted" into a litigation funding scheme; they can, however, be group members without expressly giving their active consent, and indeed this is a structural feature of the regime in Part IVA of the *Federal Court of Australia Act* and the cognate regimes in NSW, Victoria, Tasmania and Queensland.

6.4 As a consequence, in our view the proposed section 601GA(5)(a) is unnecessary and redundant, particularly in light of its stated purpose as set out in paragraph 1.45 of the Explanatory Memorandum. It should be removed from the Bill – its presence can only create confusion.

6.5 On the other hand, if the provision is intended to mandate that class actions involving litigation funders can only be conducted as closed classes, then the provision will have a deleterious impact on access to justice (because those who do not enter into a litigation funding agreement will be excluded from a remedy) and/or increase the likelihood of a multiplicity of actions as those excluded from the closed class bring separate class action proceedings for recovery. These poor policy outcomes should be avoided.

7. Definition of "class action litigation funding scheme"

7.1 We are concerned that the term "class action litigation funding scheme" has been drafted in a manner that will make it applicable to other types of civil proceedings that are not class actions. We assume this was not the intent of the Bill, and we therefore set out below our recommendation as to how the terms of the definition might be modified in order to avoid the application of the definition to legal proceedings that are not class actions.

7.2 The drafting anomaly arises from the use of the words "one or more persons" in section 9AAA(a):

> 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 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; …

7.3 The use of the words "one or more persons" in the context of section 9AAA as a whole is likely to capture other (non-class action) proceedings. On one view it captures any proceeding where a third party litigation funder funds the claim of one person. Certainly it would appear to capture insolvency proceedings brought by liquidators, receivers and administrators. Once again the unintended consequences arising from the drafting are reflective of a rushed and inadequate process.

7.4 Moreover, we note that the proposed definition of a "class action litigation funding scheme" is materially similar to the existing definition of a "litigation funding scheme" that appears at reg 7.1.04N(3). The difference being that the former declares such a scheme to be a managed investment scheme by reference to the remedies sought by claimants and the latter declares such a scheme to be a financial product by reference to the remedies sought by general members. The effect is that the proposed new definition at s.9AAA may operate coextensively with the existing definition at reg 7.1.04N(3). This is apt to create uncertainty as to the applicable law and create a situation where both definitions may apply. For example, a person carrying on a litigation funding scheme is required to hold an AFSL (reg 7.6.01(1)(x)) and to comply with the disclosure requirements in Part 7.9 (reg 7.9.98A). This overlaps with the effect of the new definition of a "class action litigation funding scheme" which declares that such a scheme is a managed investment scheme and would be subject to these same provisions if it satisfies the conditions at section 1688 of the Bill.

APPENDIX A

Maurice Blackburn is a plaintiff litigation firm established in 1919 which now has more than 1,000 staff who provide advice and legal assistance to thousands of clients in all mainland states and territories each year.

In addition to specialised practice areas in various areas of personal injury law as well as employment and industrial law and superannuation and financial advice disputes, Maurice Blackburn has the largest and most experienced class actions practice in Australia. We currently act in around 20 class actions that are active and ongoing at various procedural stages (including settlement administration) in various Australian jurisdictions including the Federal Court of Australia.

Since the establishment of our class actions practice, we have acted in more class actions than any other plaintiff law firm,[9] and we have obtained more than $3.6 billion in compensation for class members in a range of different class actions including shareholder and investor cases, product liability claims, consumer actions, cartel cases and mass tort claims. Our cases have included:

1. two class actions arising from the Black Saturday bushfires in Victoria, which settled for $494.6 million and $300 million respectively;

2. the class action arising from the Queensland floods, one half of which settled for $440 million;

3. a class action relating to the DePuy hip implants which settled for $250.8 million plus interest;

4. numerous shareholder and investor class actions, including the first ever shareholder class action in Australia as well as the first shareholder action that was conducted with support of a litigation funder. Seven of our shareholder / investor class actions have settled for more than $100 million, and we are the only firm to have achieved settlements of shareholder class actions of more than $100 million;

5. the class action against Amcor / Visy arising from the alleged cartel in the cardboard box industry, which settled for $120 million.

Our track record in achieving compensation was estimated in 2017 to account for approximately 70% of all monetary compensation that has been achieved in class actions in Australia.

We have observed and been active participants in the development of class actions practice and jurisprudence since Part IVA of the *Federal Court of Australia Act 1976* (Cth) was enacted more than 29 years ago. We acted for the representative plaintiffs in the earliest class actions that involved third party litigation funders and since then we have worked with numerous domestic and international litigation funders as the funding industry and funding practices developed over time, while also conducting many cases on a conditional fee basis.

[9] V Morabito, "The First Twenty-Five Years of Class Actions in Australia" *Fifth Report: An Empirical Study of Australia"s Class Action Regimes* (2017), page 35.

APPENDIX B

Here we set out in detail the reasons why we oppose the proposed introduction of a rebuttable presumption that 70% of claim proceeds must be distributed to class members.

1. Returns to class members – unpacking the facts

1.1 The percentage of any settlement sum returned to class members is a blunt and sometimes misleading measure of the reasonableness of a settlement. We develop and expand this issue below but at the outset we note the following:

(a) a settlement may result in a relatively low proportion of the settlement sum being class members but nonetheless compensate class members for a very high percentage of their losses. For example in *Evans v Davantage Group Pty Ltd (No 3)*[10] group members received 37.4% of the settlement sum but were likely to get close to 100% of their losses.[11] In those circumstances paying 70% of the settlement sum to group members would have overcompensated them and left either the funder or lawyers out of pocket for no good purpose; and

(b) a settlement may result in a relatively low proportion of the settlement sum being paid to group members but nonetheless represent a fair outcome if a proper analysis shows their claims are in fact close to worthless. As Beach J said in *Kuterba v Sirtex Medical Limited (No 3)*:[12]

> [A]ssume that after extensive discovery and expensive expert reports …. it is apparent that the group members have no cause of action for damages. Let it also be assumed that nevertheless the respondent is prepared to pay a modest amount to settle the matter, and let it also be assumed that legal expenses and the funding commission would soak up 90% of that modest settlement sum. Is it seriously suggested that the group members should receive at least 50% of the settlement sum for what, after forensic investigation that group members did not have to pay for and where the risk for this on their behalf was taken on and funded by others, are shown to be likely valueless claims? One can multiply such examples.

1.2 For present purposes it may be accepted that the proportion of a settlement which class members receive may provide a useful partial indicator of the level of transaction costs in the class actions system, however acceptance of that proposition does not justify the proposed introduction of a rebuttable presumption that 70% of class action proceeds must be distributed to members of the class action.

1.3 Reducing transaction costs is a desirable goal but it is not an end in itself. If the consequence of reducing transaction costs is a reduction in the amount paid to class members overall because less class actions are run, class members will be worse off and corporate wrongdoers better off – this would be a perverse policy outcome and is contrary to the stated intent of the Bill.

[10] [2021] FCA 70.
[11] Ibid at [64] and [65].
[12] [2019] FCA 1374 at [18].

1.4 Any examination of transaction costs in class actions needs to focus not just on litigation funders but also on the approach of defendants and their lawyers whose approach to the defence of class actions is often to run up as much costs as they can in order to exhaust the financial resources of those making claims.

1.5 The available datasets suggest that on average the returns to class members are more than 70% of settlement sums, with greater or lesser returns depending on the circumstances. Returns will tend to be lower (expressed as a percentage of settlement sums) in cases with third party litigation funders (where both funder and lawyer receive a return) and in smaller settlements (because legal costs charged on an hourly basis tend to be higher as a percentage of smaller settlements). However these trends do not in themselves justify a presumption that at least 70% of claim proceeds must be distributed to group members. Contingency fees remove both factors associated with higher costs – it removes funders from the equation and ensures that legal costs are calculated as a proportion of settlement amounts. Maurice Blackburn has long advocated the benefits of being able to charge a 25% contingency fee, or in other words a guaranteed return to group members of 75%. If the government were serious about reducing transaction costs it would legislate for contingency fees.

1.6 In cases with litigation funders, Professor Morabito has observed that the utilisation of common fund orders has had a significant impact on funding commissions with a median of approximately 22% for common fund orders[13] compared to median funding commissions prior to common fund orders of closer to 27%.[14] If the government were serious about reducing transaction costs for class members, it would adopt the ALRC's recommendation that the Federal Court be empowered to make common fund orders.

1.7 There have been a number of well publicised cases where returns to class members have been below those that would reasonably be expected from a class action.[15] Some of these cases featured prominently in a number of public inquiries, including those by the ALRC and the Parliamentary Joint Committee, in illustrating how the class action regime can lead to disappointing or dysfunctional outcomes for class members.

1.8 Any proper consideration of a policy response to these kinds of cases needs to consider first their prevalence (and the evidence is they are still relatively rare) and secondly the best means of reducing their incidence. The Parliamentary Joint Committee's recommendation for a guaranteed minimum payment is devoid of consideration of either.

1.9 When poor outcomes come to light, the desire to improve returns to class members is understandable. After all, the fundamental purpose of the class action regime is to recover compensation for the "genuinely wronged class action members" (to use the Parliamentary Joint Committee's words[16]) who have suffered real and tangible losses,

[13] Morabito, *Submission to Parliamentary Joint Committee* (2020), page 2.
[14] Morabito, *An Evidence-Based Approach to Class Actions Reform in Australia* (2019), page 11.
[15] The most notorious of these cases is *Petersen Superannuation Fund Pty Ltd v Bank of Queensland Ltd (No 3)* [2018] FCA 1842
[16] At page xiii.

whether they be pure financial losses or personal injury or property damage, as a result of illegal conduct.

1.10 On the other hand, access to justice rarely comes at no cost. Unlike other civil litigation, the reality is that in almost all cases class members are not required to risk any of their own funds in order to advance their claims - this is done by lawyers and funders. Experience shows that plaintiffs' legal costs in class actions are substantial, typically amounting to several million dollars, for the most part due to the complexity of the issues in dispute as well as the scale of the amounts at stake and the vigorous manner in which class actions are therefore defended, as defendants seek to create litigation risks that can be leveraged to minimise their ultimate financial liability.

1.11 In some cases plaintiffs with their lawyers also seek the support of third party litigation funders, whose importance in class actions was recognised by the Parliamentary Joint Committee:

> Litigation funding too, provides a way for representative plaintiffs and class members to meet the costs of litigation. These costs include their own legal costs and, in the event of an unsuccessful outcome, the defendant's legal costs. When litigation funders pay lawyer's [sic] fees and indemnify representative plaintiffs for adverse costs, it significantly changes the viability of class actions under Australia's 'loser pays' approach to civil litigation. Litigation funders also potentially close the considerable gap in financial resources between the two sides of a class action, reducing the defendant's ability to defeat the case through superior economic power. Therefore the committee recognises that, in many instances, a class action in Australia may not proceed without a litigation funder [emphasis added].

1.12 There is no doubt about the social utility of litigation funding in facilitating access to justice in many instances. It follows that there is nothing intrinsically objectionable about litigation funders being remunerated for the services they provide and the risks they underwrite in order to facilitate the pursuit of class actions.

1.13 In those circumstances, the real question is how to achieve an overall improvement in the returns to class members, while at the same time balancing the objective of fairly remunerating those who make it possible for class actions to be pursued at all. In our submission that question needs to be considered not only by reference to the infamous and exceptional cases in which there were particularly poor outcomes for class members, but by reference to a consideration of the performance of the class action system overall and with adoption of measures which will improve that system.

2. The 70% figure is arbitrary and there is no basis for the selection of that particular percentage

2.1 Unfortunately the Parliamentary Joint Committee's report contains no discussion of how the committee decided upon 70%, as opposed to some other percentage, as being the appropriate level to mandate as a minimum return to class members. The Explanatory Memorandum likewise contains no justification at all as to why 70% as opposed to some other percentage would be appropriate.

2.2 The Parliamentary Joint Committee itself acknowledged that the proposal for a statutory guarantee "has arisen late in the inquiry", and the only material cited in

support of it is an op-ed published in the *Australian Financial Review*.[17] As an apparent afterthought in the committee's inquiry, the policy basis for the proposed statutory guarantee and the selection of the percentage are not explained.

2.3 As noted in the minority report of the Parliamentary Joint Committee:

> Some of the statements in the report are just factually wrong. For example, Liberal members of the Committee have repeatedly cited a supposed proposal 'by some class action law firms and litigation funders to guarantee a minimum return of at least 70 per cent of the gross proceeds to class action members, and recommends the government investigate the best way to implement this floor'. To our knowledge, no law firm or funder has proposed a 70 per cent 'floor'. Rather, in the spirit of compromise, at least one law firm has proposed amendments to the Corporations Amendment (Litigation Funding) Regulations 2020 so that a litigation funder that guarantees a 70 per cent minimum return to plaintiffs would not have to comply with the managed investment scheme rules. If implemented, that proposal would arguably create an incentive for litigation funders to guarantee a 70 per cent minimum return to plaintiffs – but it would not mandate it (contrary to the suggestion by Liberal members).

2.4 In those circumstances it is perhaps unsurprising that the proposal for a minimum 70% return is devoid of substantive analysis or justification.

2.5 The only justification for the proposed guaranteed minimum return is the superficial conclusion that current returns to litigation funders are "excessive". That conclusion rests in part on the circumstances of five cases of the many hundreds of class actions which have been settled. Of those five cases, one involved deductions to settlements of less than the proposed cap (and so whatever windfall gain the litigation funder is said to have obtained would be untouched by the proposal) and in one case it is not clear what deductions were ultimately allowed from the settlement. In other words the conclusions of the Parliamentary Joint Committee appear largely to rest on the distribution outcomes of three settlements.

2.6 In reaching its conclusions regarding the "excessive" returns to litigation funders, the Parliamentary Joint Committee also placed considerable emphasis on the submission of an actuary, Sean McGing who advocated the application of investment and insurance principles in determining the fair and reasonable returns that ought to be paid to a litigation funder.[18]

2.7 Mr McGing stated that "the fair and reasonable returns for a litigation funder should be linked strongly to the level of funding it provides, together with the time horizon and level of risk undertaken".[19] In discussing investment decisions, Mr McGing goes on to state that the "risk-return trade-off states that the potential return rises with an increase in risk. Using this principle, investors associate low levels of risk with low potential investment returns, and high levels of risk with high potential investment returns".[20] A similar statement is made regarding the correlation between levels of

[17] At [13.61].
[18] Sean McGing, *Submission 101* to the Parliamentary Joint Committee.
[19] Ibid, p.3 (section 1.2).
[20] Ibid, p.5 (section 2.2).

risk and the cost of insurance, with insurers associating higher levels of risk with higher insurance costs (that is, higher premiums).[21]

2.8 Mr McGing's theoretical framework lacks any practical application to the circumstances of any actual case involving litigation funding or even application to a worked hypothetical example. What we therefore do not know is the type or range of returns that would actually be justified by the application of investment and insurance principles of risk-reward to a range of different circumstances involving litigation funding. In some cases it might justify a return to the funder that is equivalent to more than 30% of the gross claim proceeds. For example, in the hypothetical below, presumably in Case 1 the fair and reasonable returns to a funder would be significantly higher than in Case 2, both in absolute dollar terms and also when expressed as a percentage return on investment.

Hypothetical example 1

	Case 1	**Case 2**
Investment	$20 million for the plaintiff's legal costs	$5 million for the plaintiff's legal costs
Time horizon	4 years	3 years
Downside risks	$30 million in adverse costs, plus loss of $20 million investment	$6 million in adverse costs, plus loss of $5 million investment
Level of risk	High due to risks and uncertainties in establishing liability and the potential insolvency of the defendant	Low due to strength of liability case and minimal procedural risks

2.9 Further it is plain that the application of Mr McGing's theoretical framework provides no support for the proposed 70% statutory minimum calculated by reference to a percentage of settlement outcomes. His entire approach is to eschew the calculation of an appropriate return by reference to the settlement outcome and focus instead entirely on input costs. In practice such an approach would often lead to returns to class members much less than the proposed 70% of settlement proceeds - indeed one of the cases on which the Parliamentary Joint Committee report relies (*Petersen v Bank of Queensland*) is just such a case.

2.10 In discussing the possible operation of a mandatory sliding scale[22] for the evaluation of legal costs and funding charges in comparison to the resolution sum, the ALRC considered that it may be "too blunt an approach that does not allow for differences of risk in individual cases".[23] We agree with that assessment and consider that the same comment can be made about the proposed rebuttable presumption. One of the main reasons why the approach is too blunt is that it is not possible to predetermine

[21] Ibid, p.6 (section 2.3).
[22] A sliding scale is similar to the proposed statutory guarantee of minimum returns, except that the sliding scale provides for a range of minimum returns depending on the size of the resolution sum.
[23] ALRC Discussion Paper, [5.70].

or predefine what may be fair and reasonable in the wide-ranging circumstances of different cases. The fact that the presumed 70% return is able to be rebutted does not cure this vice in the proposed section 601LG(6).

2.11 Judges supervising class actions and considering whether to approve settlements are best placed to form judgments about what is fair and reasonable in these wide-ranging circumstances. Far from simply rubber-stamping the distribution of settlement proceeds put forward by the parties in class actions, it is abundantly clear that judges give real and serious consideration to the fairness of proposed distributions. Increasingly this occurs with the assistance of independent contradictors[24] whose role it is to advocate the interests of class members. In some cases this has resulted in judges disapproving settlements or encouraging the parties to put forward an alternative allocation of settlement funds. In other cases, judges have refused to make common fund orders, particularly where it was not in the interests of justice to do so – for example in the Volkswagen class actions (also discussed below).[25]

3. The wrong denominator is being used to evaluate returns to class members

3.1 The proposed guaranteed return to class members is expressed as a percentage of the gross claim proceeds. In other words, the numerator in the equation is the dollar amount that will flow to class members, and the denominator is the dollar amount of the gross settlement sum, and the product is a percentage return. For the reasons discussed below, this is another reason why the proposed presumption requiring a 70% return is arbitrary and is likely to lead to unprincipled outcomes.

3.2 Instead the denominator in the equation should be the likely estimate of class members' aggregate losses, or in other words their likely recovery. That is the appropriate benchmark against which the reasonableness and fairness of the amount flowing to class members should be assessed. Again this was addressed by Beach J in *Evans v Davantage Group Pty Ltd (No 3)*, which was also cited above. In that case his Honour made the following observations:[26]

> It is important not to confuse two types of percentages. Let me illustrate by the present case. A fund of 37.4% of the gross settlement sum of $9.5 million is to be set aside for group members. But we know that only 1,244 group members, including 97 who registered after the registration deadline, have registered to participate in the settlement. And on the current arithmetic they are likely to get close to 100% of their claims. Indeed, on one view the current form of the SDS allows them to get more. And it is for that reason that I will discuss later the potential application of the cy-prés doctrine. <u>So the present case is a good example of the fallacious reasoning of those who take headline percentages of gross recoveries from settlement sums and seek to transmute them into the real returns of group members</u> who have taken proper steps to protect their interests by registering their participation in any settlement.

[24] Even in cases where it was apparent that the plaintiff's lawyer and funder misled the Court, an independent contradictor has assisted the Court to uncover and where possible remediate the consequences of unlawful or improper conduct: see for example the Banksia Securities fiasco in the Supreme Court of Victoria.
[25] *Cantor v Audi Australia Pty Ltd (No 5)* [2020] FCA 637 at [472]; see generally [280]-[476] for the Court's consideration of the applications made in relation to litigation funding. Maurice Blackburn had conducted three of the five class actions, with the two other class actions being conducted by Bannister Law with a litigation funder (Grosvenor) who sought a common fund order.
[26] [2021] FCA 70 at [65].

> Such a class in the case before me are likely to receive close to 100% of their claims plus interest. On any view they will receive much more than 37.4% of their claims plus interest. So, you are dealing with different percentages [emphasis added].

3.3 In order to illustrate the point made by Beach J regarding the inappropriateness of the gross resolution sum being used as the benchmark to evaluate reasonableness of the amounts flowing to class members, contrast the following hypothetical involving two different settlements, assuming that in both cases:

(a) class members receive 100% of their best case damages; and

(b) the Federal Court considers the same dollar amount of legal costs ($10 million) to be reasonable in the circumstances.

3.4 The percentages in brackets in this table are the percentages of the gross settlement sum.

Hypothetical example 2

	Case A	Case B
100% of class members' losses	$15 million (42.8%)	$50 million (71.4%)
Legal costs	$10 million (28.5%)	$10 million (14.3%)
Funder's remuneration	$10 million (28.5%)	$10 million (14.3%)
Gross settlement sum	$35 million (100%)	$70 million (100%)

3.5 Both of these cases ought to be regarded as fair and reasonable even though there are differences in the percentage returns to class members when expressed as a percentage of the gross claim proceeds. Despite class members in both Case A and Case B receiving 100% of their losses, the settlement in Case A would fall foul of the 70% presumption simply because the percentage of class members' returns in comparison to the resolution sum is 42% instead of 71%. In Case B the same amount of legal and funding costs would be acceptable under section 601LG only because of the fortuity that the dollar amount of class members' claims is greater than in Case A.

3.6 Due to the fact that it contains an exhaustive list of factors and expressly disallows consideration of other potentially relevant factors, in the above example the apparent effect of section 601LG(1) is that the court would not be able take into account the real returns to group members (expressed as a percentage of their best case damages) when considering whether it was justifiable to depart from the rebuttable presumption in section 601LG(6). Instead the application of section 601LG would result in an arbitrary reallocation of the claim proceeds leading to over-compensation of group members.

3.7 As can be seen, unprincipled and unfair outcomes are likely to be produced by the combination of (1) the arbitrary adoption of 70% rather than some other percentage and (2) the use of the gross resolution sum as the benchmark against which the percentage returns to class members are compared and (3) the fact that section

601LG(1) does not allow the courts to take into account group members' best case recovery in deciding whether it was appropriate to depart from the presumed 70% return.

3.8 As discussed in this next section, the inappropriate use of the gross settlement sum as the denominator also obscures the reasonableness of the compromises that will inevitably (but often justifiably and reasonably) be made in relation to class members' claims as a result of the risks and uncertainties that confront them.

4. Class actions are risky and unpredictable, and compromises in settlements are routine

4.1 Compromise occurs in the settlement of almost all litigation, and class actions are no exception. This is of course because litigation is not devoid of risk, and compromises in resolving litigation typically recognise or reflect the fact that the parties face an uncertain outcome to some degree or another and for one reason or another. More specifically, agreement on financial amounts payable to the aggrieved party is usually influenced by assessments of risk and uncertainty in the litigation. Again, class actions are no exception, and indeed it may be said that class actions carry additional and/or more acute risks in comparison with general commercial litigation.

4.2 The types of risks in class actions can be categorised as follows:

(a) **Liability risks** – in other words, there is a risk that the plaintiff may not be able to establish all matters that need to be proven in order for the defendant to be found liable. These risks are usually amplified in cases involving complex scientific or technical issues, as is often in the case in class actions.

Although a relatively extreme illustration of this issue, one example is the Vioxx class action where the plaintiff established at trial that the Vioxx medication had an increased propensity to cause heart attacks. However on appeal the Full Federal Court found that the plaintiff did not establish that his heart attack had in fact been caused by this increased propensity. The risk that similar findings would be made in respect of many or even most class members appears to have been one of the central reasons why a heavily discounted settlement was later agreed.[27]

(b) **Damages risks** – this is the risk that the plaintiff will fail to prove the extent of the loss and damage that was caused by the contravening conduct, or where different formulations of loss and damage are put forward, that the plaintiff will only succeed on a relatively unfavourable formulation. For example, despite some recent judgments of the Federal Court,[28] the validity of the "event study" methodology for proving loss in shareholder class actions might be said to remain uncertain because it has not yet been considered by an appellate court.

[27] *Peterson v Merck Sharp & Dohme (Aust) Pty Ltd (No 6)* [2013] FCA 447; *Peterson v Merck Sharp & Dohme (Aust) Pty Ltd (No 7)* [2015] FCA 123.
[28] *TPT Patrol Pty Ltd as trustee for Amies Superannuation Fund v Myer Holdings Limited* [2019] FCA 1747.

(c) **Procedural risks** – in addition to the types of procedural risks that exist in litigation generally, there are also risks that are unique to class actions; for example the prospect that a "de-classing" order is made pursuant to section 33N of the Federal Court Act, which would bring an end to the pursuit of class members' claims in the aggregated form of a class action.

(d) **Recovery risks** – these relate to the capacity of the defendant to pay any settlement or judgment amount, and include the risk of insolvency and the availability of responsive insurance. In class actions this risk may be amplified due to the quantum of amounts that are normally at stake.

4.3 These types of risks all inform the question of whether a compromise of class members' claims was reasonable in the circumstances of a particular case. Indeed this is why the Federal Court's *Class Actions Practice Note (GPN-CA)* already expressly requires the following factors (among others) to be addressed in any application for settlement approval:

(a) the complexity and likely duration of the litigation;

(b) the stage of the proceedings;

(c) the risks of establishing liability;

(d) the risks of establishing loss or damage;

(e) the risks of maintaining a class action;

(f) the ability of the respondent to withstand a greater judgment;

(g) the range of reasonableness of the settlement in light of the best recovery;

(h) the range of reasonableness of the settlement in light of all the attendant risks of litigation.

4.4 These factors in the *Class Actions Practice Note* reflect well established principles from a long line of authority. It is entirely appropriate for all of these considerations to be taken into account in evaluating whether a settlement, including the proportion of the claim proceeds to be paid to class members, is fair and reasonable in the circumstances. However the Court's ability to do so will be constrained by the enactment of the rebuttable presumption in section 601LG(6). Together with the limited list of factors that can be considered pursuant to section 601LG(1), the rebuttable presumption in section 601LG(6) will have the practical effect of constraining the court's consideration of all of the factors that are relevant to settlement approval. This is because the funder's remuneration cannot be considered in isolation from the overall settlement "package", but instead is inexorably linked to other aspects that bear upon the fairness of a settlement as a whole.

4.5 This is another reason why the denominator in the equation should be the estimate of class members' likely losses, and not the resolution sum. It enables the returns to class members to be evaluated against their likely result, but taking into account the

risks confronted by class members and therefore whether the compromise of class members' claims was reasonable in the circumstances.

4.6 We illustrate this problem with a more detailed description of circumstances in the following hypothetical.

Hypothetical example 3

A mass tort class action arising from mismanagement of a dam in a Tasmanian city settles for $100 million inclusive of legal costs and funding fees.

The class action was brought on behalf of residents and businesses in two separate geographical areas (Area A and Area B) that experienced major flooding as a result of the alleged mismanagement of the dam. At the time the class action was commenced, the plaintiffs' lawyers estimated that the loss and damage suffered by class members in Areas A and B was in each case $75 million, with a combined total of $150 million.

Shortly before trial, the defendants served an expert report which convincingly demonstrated that Area A did not experience flooding as a consequence of the negligent operation of the dam, but instead due to unusually heavy rainfall in that area which would have resulted in flooding regardless of the manner in which the dam was operated. As a result, the plaintiffs were only able to establish that Area B was affected by the mismanagement of the dam, and soon after service of the defendants' expert evidence a settlement was agreed on the basis that residents and businesses in Area B (but not Area A) will receive compensation.

Legal costs up to the point of settlement were $20 million, while claim proceeds distribution method sought payment of 15% of the gross proceeds.

Under the terms of the settlement, it was proposed that those in Area A receive $0 compensation (consistently with the facts established by the expert evidence), with the entirety of the net settlement funds ($65 million) to be paid to residents and businesses in Area B, who would therefore receive 87% of their estimated $75 million losses.[29] The 87% return to class members was considered to be a reasonable compromise in light of the overall litigation risks faced by class members in Area A, including the prospect of a lengthy trial and all of the attendant risks and uncertainties.

The following table shows how the gross settlement sum is to be allocated among class members, the lawyers and funder, contrasting the actual scenario at the time of settlement with the scenario predicted by the lawyers and funder at the time the class action was commenced.

[29] Net proceeds of $60 million equal 80% of the $75 million in loss suffered by residents and business in Area B.

	Predicted at commencement	Actual settlement
Claim proceeds	$200 million	$100 million
Legal costs	$20 million	$20 million
Funding costs (15% of gross)	$30 million	$15 million
Net funds to class members	$150 million	$65 million
Percentage return to class members	75%	65%

4.7 As in Hypothetical 2 above and also in the *Evans v Davantage* decision discussed above, presumably in this situation there would be some type of reallocation of the claim proceeds if 70% presumption were applicable. However the practical operation and consequences of the presumption are unclear. Should the $5 million in funds be reallocated from the lawyers or from the funder, or both? Should the reallocated funds flow to residents and businesses only in Area B, thereby boosting their returns from 87% to 93% of their actual losses? Or should the $5 million be allocated to those in Area A, giving them 7% of their actual losses[30] even though the expert evidence established that they suffered no loss as a result of the allegations in the class action?

4.8 As an aside, it can also be seen that in the initial predicted outcome, the litigation funder would have received a funding commission that is twice as much as the actual commission upon settlement ($30 million compared to $15 million). Ironically, if the predicted outcome had in fact occurred, the statutory guarantee would have allowed the funder to receive much higher remuneration of $30 million having undertaken the same level of risk and expenditure, whereas in the actual outcome the presumed 70% return would not allow the funder to receive half that amount; that is, $15 million. If the concern that underlies the introduction of the Bill is that litigation funders' fees are "excessive" as noted above, this example illustrates how the operation of the Bill would be dysfunctional in achieving the goal of reducing litigation funders' fees.

4.9 In a number of judgments in which the proportionality of legal costs was considered, the Federal Court has also recognised that the concept of proportionality involves more than simply comparing the amount payable to lawyers (or funders) with the overall resolution sum: *Earglow Pty Ltd v Newcrest Mining Ltd* [2016] FCA 1433 at [99] and *Caason Investments Pty Ltd v Cao (No 2)* [2018] FCA 527 at [148]. In *Blairgowrie Trading Ltd v Allco Finance Group Ltd* [2017] FCA 330, Beach J said at [181]:

> But what is claimed for legal costs should not be disproportionate to the nature of the context, the litigation involved and the expected benefit. The Court should not approve an amount that is disproportionate. But such an assessment cannot be made on the simplistic basis that the costs claimed are high in absolute dollar terms or high as a percentage of the total recovery. In the latter case, spending $0.50 to

[30] 7% equals $5 million compared to $75 million.

> recover an expected $1.00 may be proportionate if it is necessary to spend the $0.50. In the former case, the absolute dollar amount as a free-standing figure is an irrelevant metric. The question is to compare it with the benefit sought to be gained from the litigation. Moreover, one should be careful not to use hindsight bias. The question is the benefit reasonably expected to be achieved, not the benefit actually achieved. Proportionality looks to the expected realistic return at the time the work being charged for was performed, not the known return at a time remote from when the work was performed; at the later time, circumstances may have changed to alter the calculus, but that would not deny that the work performed and its cost was proportionate at the time it was performed. Perhaps the costs claimed can be compared with the known return, but such a comparison ought not to be confused with a true proportionality analysis. Nevertheless, any disparity with the known return may invite the question whether the costs were disproportionate, but would not sufficiently answer that question [emphasis added].

5. Unintended consequences may harm class members' interests

5.1 Another problem with the proposed statutory guarantee is that it may have unintended consequences that undermine the interests of class members. The most obvious of these counterproductive consequences is that the statutory guarantee could have the effect of imposing a cap on a plaintiff's "war chest", thereby restricting the capacity of lawyers to act effectively in class members' interests. There is of course also the likelihood that defendants will seek to exploit this limitation. This is illustrated by the following hypothetical.

> **Hypothetical example 4**
>
> A class action is brought by members of a managed investment scheme in relation to misleading statements made in the prospectus.
>
> Members of the MIS invested a total of $30 million, and the total estimate of class members' losses is therefore $30 million. This would obviously be known by the defendant.
>
> The operation of the 70% statutory guarantee would mean that legal and funding costs must be $9 million (that is, 30% of $30 million) or less. This would obviously also be known by the defendant.
>
> The defendant engages in tactics of delay and attrition, including multiple interlocutory disputes and appeals from interlocutory decisions, as well as unsuccessful and unmeritorious "satellite litigation" brought against the plaintiff's lawyers as a result of alleged misuse of confidential information. As a result, shortly before the commencement of the trial and without yet having been able to secure a result for the plaintiff and class members, the plaintiff has already incurred $9 million in legal costs.

5.2 The question that arises in this situation is what the plaintiff and lawyers are supposed to do as a result of their war chest having been exhausted. Could the plaintiff's lawyers be forced to continue providing legal services on a gratuitous basis? Or would it have the practical effect that the plaintiff and class members abandon their claim because the lawyers will no longer act without being remunerated? The potential for

conflicts of interest between lawyers and class members in this situation is also self-evident.

6. Not all settlements involve an "all in" gross resolution sum

6.1 The most common type of class action settlement is an "all in" settlement involving payment of a global resolution sum that includes legal costs and, if applicable, funding charges. However not all settlements are structured in this way, and it is unclear how a statutory guarantee of a 70% return to class members would operate in the context of different settlement structures. Here we provide two examples of alternative settlement structures among our recent cases. Although both of these cases did not involve litigation funding, the structure of these settlements raises important questions about how the rebuttal presumption in section 601LG(6) would be applied in circumstances where a settlement does not involve a global settlement sum that is inclusive of all legal and funding costs.

Volkswagen diesel emissions class actions

6.2 This group of class actions was settled on the basis of a "plus costs" structure as follows:[31]

(a) Payment to class members: the defendants agreed to pay between $89 million and $127.1 million solely for class members, with the final amount within that range to be calculated by reference to the number of vehicles in respect of which class members registered claims and were found to be eligible according to specified criteria in the settlement scheme. In discussing the entitlements of class members to share in the final sum, the Federal Court noted that:[32]

> The applicants were genuinely at risk of coming up short and failing to prove any loss. Furthermore, there was considerable force in the proposition that, ultimately, such loss as could be proven was no more than about 10% of the market value of the affected vehicles as at September/October 2015. If that were to be the result of this very serious and expensive forensic contest, then the settlement which has been agreed compares very favourably indeed with that postulated result [that is, 10% of the market value of the vehicles in late 2015].
>
> In the end, I had no difficulty at all in accepting that the financial terms of the settlement were fair and reasonable having regard to the interests of the class members as a whole. In addition, given the care with which the comparative merits of individual claims have been considered and resolved in the methodology ultimately agreed upon, I was also firmly of the view that the settlement was reasonable as between individual group members.

(b) Payment of costs: on top of whatever amount was finally determined to be payable to class members, the defendants additionally agreed to pay the plaintiffs' legal costs as well as settlement administration costs, with the amount of those costs to be determined by the Court, informed by evidence from an

[31] *Cantor v Audi Australia Pty Ltd and Others (No 5)* [2020] FCA 637.
[32] *Casey v DePuy International Ltd* [2012] FCA 1370 at [231]-[232].

independent costs expert. In discussing the reasonableness of financial aspects of the settlement, the Federal Court noted that:[33]

> Given that the respondents have agreed to pay the applicants' legal costs and certain other expenses in addition to the Aggregate Settlement Sum [which is defined as being *exclusive* of legal costs], the individual group members' entitlements will not be reduced by the deduction of any amount to cover those costs and disbursements.

6.3 In circumstances where the amount for class members and the amount for legal costs were separated and there were therefore no deductions from the sum payable to class members, it is unclear how the rebuttable presumption would operate. Would the rebuttable presumption operate to require the two amounts be added together to make a "total resolution sum" simply in order to assess whether class members were to receive more than 70% of that total resolution sum, regardless of the settlement structure and other circumstances and features of the case? Although the settlement administration is ongoing and therefore at the present time there remain some uncertainties about final figures, it appears likely that the total costs would be slightly more than 30% of the reverse-engineered total resolution sum.

DePuy knee implants class action

6.4 This case settled on the basis of a "process settlement" that did not involve payment of any global resolution sum. Rather, the case was settled by the parties agreeing on the process by which class members' injuries and compensation entitlements would be individually assessed, and with class members then receiving whatever amount they were individually assessed as being entitled to receive.

6.5 Legal costs were to be paid partly by the defendants directly, with the balance being paid by individual class members. Some of those legal costs related to work done for the benefit of the class as a whole, while other costs were referable to the work done to prepare individual claims.

6.6 It is unclear how any statutory guarantee would operate in this circumstance, particularly given that:

(a) the settlement was approved by the Federal Court in December 2012;

(b) although many individual class members' claims have been assessed and finally paid by the defendants, the court-approved settlement protocols allow for claims to be made up to eight years after implementation of the knee implant in question, with the result that some claims are still ongoing for this and other reasons.

6.7 In other words, some 9.5 years after the settlement was approved, we still do not have final figures relating to the aggregate quantum paid / payable to class members or the total amount of legal costs. As such, it is still not possible to determine the final percentage returns that will have been or are to be paid in aggregate to class

[33] At [208].

members, nor do we have final figures for total legal costs. There is also the added complication that individual class members can choose their own lawyer to prepare their individual claim in the settlement, so a number of different law firms have acted on behalf of class members. If a statutory guarantee were to be introduced, in those circumstances would it be necessary to hold back compensation payments of all class members for ten or more years until these final amounts are known, such that any necessary reallocation or adjustment of payment proportions can be undertaken at a later time in order to ensure compliance with the statutory guarantee?

7. The proposed cap will reduce access to justice

7.1 Although the evidence suggests that the class action regimes have resulted in average returns to class members of around 70%, it is also the case that a not insignificant proportion of class actions have resulted in returns to group members of less than 70%. As the above analysis demonstrates this is generally not to do with "windfall" profits of litigation funders but the function of a range of matters including:

(a) the complexity of class action litigation;

(b) the approach of defendants and defendant lawyers in running up costs;

(c) the inability of lawyers to charge fees on a percentage basis;

(d) the fact that funded cases involve a litigation funder and a lawyer who must both receive a return as a result of the services they provided in order to make it possible for the class action to be commenced at all;

(e) the fact that 50% of cases settle for $36 million or less.[34]

7.2 If the proposed rebuttable presumption is introduced the inevitable consequence will be a substantial reduction in the number of cases brought by claimants and a likely overall reduction in amounts payable to class members. A case which might settle for less than $36 million will generally be uneconomic for a litigation funder to fund in circumstances where defendants will ensure costs eat up most if not all of the 30% cap. Only a few law firms will have the capacity or risk appetite to take on such cases on a conditional fee basis and so those cases will often simply not proceed. Importantly the effect on cases will not be limited to those that do settle for less than $36 million but for those cases which might. The upshot being fewer cases and a likely reduction in overall compensation to class members (because those cases which settle for higher amounts are much less likely to bring the proposed statutory guarantee into effect in any event).

[34] Morabito, *An Evidence-Based Approach to Class Actions Reform in Australia* (2019), page 10.