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Committee Secretary
Parliamentary Joint Committee on Corporations and Financial Services
PO Box 6100
Parliament House
Canberra ACT 2600

10 June 2020

Submission to the inquiry into litigation funding and the regulation of the class action industry

Dear Committee Secretary

We write on behalf of Balance Legal Capital LLP. We are a London-based litigation fund manager focused on commercial litigation and arbitration in the UK, Australia and other common law jurisdictions. Our core team comprises litigators drawn from Herbert Smith Freehills and Freshfields, two of the largest and most highly-regarded international law firms. Our investment and case management decisions are made by an Investment Committee including Lord David Gold, former global head of Herbert Smith and head of their global dispute resolution group, and Ian Terry, former global managing partner of Freshfields and head of their global dispute resolution group. Our senior advisors to the Investment Committee include Fraser Shepherd, a former litigation partner at Gilbert + Tobin in Australia and Nick Gardner, the former head of intellectual property litigation at Herbert Smith. We take pride in selecting the most meritorious cases after a highly rigorous due diligence process.

The Australian Parliamentary Inquiry is examining "litigation finance" which is a large and complex topic. With law firm partners' hourly rates usually at $700 plus GST and the best barristers commanding day rates of up to $20K, redress through litigation is out of reach for individuals and small-to-medium sized businesses who often find themselves facing better resourced multi-national corporations and financial institutions. A litigant must not only be able to meet their own legal costs but also the legal costs of the other side if unsuccessful. Litigation finance exists because litigation is expensive, complex and high risk.

Australia has a talented and fiercely independent judiciary more than capable of ensuring that meritorious parties prevail and that claimants and defendants are treated fairly. The combination of competitive market forces in the supply of capital, the scrutiny of lawyers and judges who owe their duties to the litigants not funders, and the financial penalties to funders if their case selection goes wrong, serves to ensure that non-recourse funding of litigation generally goes to the right cases and at a price commensurate with the substantial risks.

The recent and extensive independent reviews into the class action system and litigation funders by both the Australian Law Reform Commission (**ALRC**)[1] and Victorian Law Reform Commission (**VLRC**)[2] showed that the current system is functioning well and that it provides redress to businesses and individuals. We are concerned that the system is in danger of being dismantled under the influence of misconceptions about litigation funding promulgated by big business and others that are exposed to class actions when they breach relevant laws that cause loss to investors, customers or other stakeholders. We make the below submission to emphasise how litigation finance works and why some of the concerns raised are misplaced.

[1] ALRC Final Report – "Integrity, Fairness and Efficiency—An Inquiry into Class Action Proceedings and Third-Party Litigation Funders" – Dec 2018
[2] VLRC Report March 2018 – "Access to Justice: Litigation Funding and Group Proceedings"

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1 The litigation finance business only works for meritorious cases

Whilst all funders must expect to lose some cases because of the risks and uncertainty inherent in litigation, no funder can sustain a business by investing consistently in bad cases for the simple reason that in so doing they not only lose their capital investment (usually millions of dollars) but also have to pay the costs of the winning party (usually also millions of dollars).[3] A litigation fund manager that consistently picks unmeritorious cases will lose money and not be able to raise further capital and the business will fail.

At Balance we have assembled an expert team that understands the risks and complexities of litigation. We are highly selective, and have built a rigorous due diligence process such that we only invest in a single digit percentage of the cases submitted to us. Case selection is complex – the case must meet a number of criteria in order to be "fundable", in terms of quantum, jurisdiction, recovery risk, legal budgets covering lawyers, expert witnesses, and other disbursements, and adverse costs and security for costs. Above all, the case must have **strong legal and factual merits**, and for us must also pass the "newspaper front page" test where we ask ourselves whether we would be happy to be publicly associated with the case.

The work we put in to establish the merits of the case from a factual and legal perspective is significant and we know that many other funders operate in a similar way. We test the lawyers and the key witnesses; we review and test documentary evidence and legal opinions. Only if the case passes these threshold tests do we table an investment memorandum to our investment committee for further thorough scrutiny. We often engage independent counsel and experts to provide a further view on specialist or technical issues.

Meritorious and fundable cases usually attract competition with other funders which ensures that whoever ends up funding the action does so at a competitive price. A significant amount of work is required to document and negotiate the litigation funding arrangements, involving multi-lateral contracts with the claimant, the law firm, counsel, and adverse costs insurers. Once funding is agreed, we monitor the case closely to ensure that lawyers and counsel are running the matter efficiently and to budget. In doing so, we are often providing a (free) service to our funded clients (and group members, in the case of class actions) who are often not themselves experienced in making assessments as to what are reasonable legal costs.

If there is an adverse development during a case that significantly affects the merits of the case, then we seek advice from the lawyers and counsel and, together with the plaintiff, make a decision as to whether the case should continue to be pursued. Our funding documentation allows us to cease funding claims that become unmeritorious and in many instances the terms of adverse costs insurance do not provide cover in the event that unmeritorious claims are pursued. We are therefore aligned with plaintiffs, group members and the courts in ensuring that only good cases proceed and that these good cases are resolved in a manner that maximises recovery and minimises costs.

2 Litigation funding is pro-business

There appears to be a misconception that litigation funding "hurts business". This is incorrect. While some of our funding assists consumers, investors and shareholders claiming against businesses whose misconduct has caused them loss, another significant focus of our funding involves assisting businesses by funding commercial litigation claims on their behalf where they would prefer to use their cash for other purposes or where those businesses are unable to finance the cost of vindicating their legal rights themselves through litigation. These might be breach of contract claims, torts, private shareholder disputes, patent infringement claims, or competition claims. We enable those businesses to use their cash flow for their business instead of their lawyers. That cash will often support payroll and create jobs - leaving aside the fact that the legal industry is itself a huge employer in Australia.

[3] TPT Patrol Pty Ltd as trustee for Amies Superannuation Fund v Myer Holdings Limited [2019] FCA 1747

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The virtue of "business" in itself is of course something we all understand – but it is inaccurate and counterproductive to cast litigation funding as being a "threat to business" and it only serves to distract and confuse the issues. For example, Balance is currently funding a class action for Australian farmers in Queensland and New South Wales against one of the world's largest seed manufacturers whose contaminated sorghum seed has caused loss to over 100 family-owned farming businesses. Without our support no route for redress would have been available for the farmers. Litigation finance is simply another form of finance available to businesses that only flourishes when it is applied to meritorious cases.

3 Class actions help ordinary Australians obtain redress from otherwise intransigent defendants, which in many cases would be impossible without litigation finance

Litigation is disproportionately expensive and the courts' time too precious to have a single claimant fighting individually low value cases against banks, insurance companies, and car manufacturers when there are hundreds if not thousands of individuals affected by the same corporate malfeasance. The class action regime has allowed ordinary Australians to come together to obtain redress, often with the assistance of a litigation funder who can bring specialist lawyers and experts together to make the claim possible. Australia's class action system should be celebrated, not inhibited.

Litigation funding is provided on a non-recourse basis so that if the case loses, funders lose their investment and claimants have no downside risk.[4] Because litigation is so expensive we can only fund low value cases where they can be aggregated into a sum large enough for funders' capital costs to be met while still leaving claimants with the lion's share of the claim value. This is why open class actions and common fund orders are to be welcomed: the damages owed to an entire open class can be aggregated and orders made to effect a just and equitable distribution of compensation, costs and finance costs. It also means potentially unwelcome and expensive marketing campaigns to build a book are avoided – and group members get a better deal.

Class actions that Balance is funding include:

1. A class action against Advanta Seeds on behalf of 100+ farmers in New South Wales and Queensland. Farmers were sold a contaminated seed which has harmed the yield of their farms. Judgement is pending. (Queensland Supreme Court).

   Claimant and spokesperson for the farmers, Bernie Perkins said "*The recent Sorghum Shattercane Class Action, run by Creevey Russell and funded by Balance Legal Capital, has meant many sorghum growers who were severely financially affected by negligence from a large multi-national in production of seed, have been able to join together to seek justice and damages for their loss. Without funding and a class action system this would not have been possible. Many growers could not afford it, despite their substantial losses.*" (June 2020)

2. A class action against Toyota on behalf of 150,000+ owners (individuals and businesses) of Toyota diesel cars (Hilux, Fortuna, Prado) with allegedly defective diesel particulate filters. (Federal Court, New South Wales).

   Ken Williams, the lead representative in Toyota class action said, "*Balance has helped me bring the case for everyone. Without the support of Balance I wouldn't have had any way of getting the problem fixed. Toyota were completely unreasonable. I would have just walked away from it and I would have been another person that they just walked all over.*" (June 2020)

3. A class action against Swann Insurance / IAG on behalf of individuals sold insurance products that were unsuitable for them and/or had no, or no material, value. (Federal Court, New South Wales)

[4] Balance indemnifies group members for adverse costs risk.

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Without litigation funding, ordinary Australians have no credible avenue to obtain redress once they have exhausted the relevant company or regulator (if there is a relevant regulator) complaints process. Absent the possibility of a funded class action, companies have little incentive to provide adequate compensation to customers, particularly when the aggregate amount of compensation required would be large. Without litigation funding supporting these claims, businesses have no incentive to change bad business practices and improve.

There is no legal aid or 'public fund' for meritorious class actions. The availability of third party funding levels the playing field so that cases can be brought in the first place; properly prosecuted; and then decided on their merits. Without third party funding, culpable defendants could ignore claims or deploy their superior influence and resources to delay dealing with claims and/or bleed claimants dry. Decisions to settle by defendants are made with the advice of highly specialised lawyers who can be expected to advise defendants to defend the case at a full and final hearing if the merits are in their favour. In practice, defendants often settle class actions against them – this is not surprising, given the amount of due diligence that is done by funders to satisfy themselves that a proposed class action has very strong merits before a decision is made to fund that action.

4 Litigation funder profits are exaggerated and misunderstood

As reported in the Sydney Morning Herald, the litigation funding industry in Australia made $44.8M in profit for 2017-2018.[5] As against the $29.5BN of profits reported by the major Australian banks,[6] and $1.3BN in profit for automotive wholesalers,[7] in the same year, the idea that funders are harming these businesses is simply not supported by the data.

The Australian litigation funding industry is amongst the most mature in the world. Funding commissions are the product of competitive markets (as between funders, and in attracting capital from investors), freedom of contract (with claimants and group members), and scrutiny by judges (who have many tools at their disposal to protect claimants, group members, and defendants). When we select cases we are at pains to ensure that the economics will result in the funded party taking the lion's share of the damages. The proportion of the final sum retained by the claimants is a function of costs incurred in bringing the cases, the application of the facts to the law, the willingness of the parties to settle, and when. Litigation is inherently uncertain. The higher the costs and the greater the risk, the higher the commission necessary such that a funder's portfolio can operate to allow winning investments to pay for the losing/underperforming ones.

As reported by the ALRC, in funded class actions in the Federal Court, about 30 percent of the litigation proceeds in class actions went to funders, 51 percent to affected shareholders and 17 percent to legal costs.[8] Whilst it is reported that in unfunded class actions, group members received a higher proportion of the damages this is not to say that litigation funding is a problem *per se*. There is no such thing as an "unfunded" class action - *someone* was funding the claim – be it the group members themselves, or a law firm acting on 100% conditional fee. Self-funding class actions are usually not an option because the case is too complex and/or expensive and no lead plaintiff is willing to bear individually the costs and adverse costs in pursing an action on behalf of the entire group.

The notion that without regulation, funders are "left to their own devices" ignores the forces that keep commissions in check and commensurate with the risk. The majority of funders have qualified solicitors and barristers as part of their senior management team meaning that decisions in these businesses are made by those that must act in accordance with professional obligations. Any funder wishing to charge too much will simply lose business to competitors who may have lower costs of capital or be able to price the risk more

[5] https://www.smh.com.au/business/banking-and-finance/class-warfare-the-fight-over-corporate-australia-s-most-reviled-legal-tactic-has-begun-20200528-p54x67.html
[6] KPMG Report 'Major Australian Banks Full Year 2018 Results Analysis': https://assets.kpmg/content/dam/kpmg/au/pdf/2018/major-australian-banks-full-year-2018-results-analysis.pdf - p4.
[7] https://www.accc.gov.au/system/files/New%20car%20retailing%20industry%20final%20report_0.pdf - p29
[8] ALRC Report – Table 3.7 – Median settlement and return for Part IVA matters finalised in the federal Court (2013 – October 2018) p83.

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competitively. The claimant receives its proceeds less the funding costs, leaving them with something rather than nothing, having borne no risk.

5 Regulation will reduce access to justice without protecting anyone but defendants and Australian funders

There have been calls for "regulation" of litigation funders but it is not clear what the objectives of such regulation are. Are those calling for regulation seeking to: (i) protect investors in litigation funders; (ii) protect claimants or group members in class actions; (iii) protect defendants; or (iv) discriminate in favour of local litigation funders by increasing costs for overseas-based funders?

(i) As regards investor protection:

a. As a manager of a multi-investor fund based in England, we are regulated by the UK's Financial Conduct Authority (**FCA**) whose remit is to ensure that investors are protected. As part of our FCA authorisation process, our team was scrutinised to ensure that we had the expertise, resources and systems necessary to make and manage investments in the litigation finance asset class. ASIC has a similar remit to the FCA. Neither ASIC nor the FCA is competent to decide on the merits of the investments that litigation funders make – these are complex legal and commercial questions that specialist lawyers opine on and argue, but which are ultimately determined by judges and arbitrators deciding the case. Indeed, ASIC made this very submission to the ALRC when it stated that the court was '*better placed to regulate litigation funders, through court rules and procedure, oversight and security for costs*'.[9]

b. To classify a class action litigation funding arrangement as a managed investment scheme is a misnomer. Class actions entail the pooling of causes of action – not capital from a group of investors. The only capital going in is the funders' in paying legal fees and disbursements on behalf of group members. It is not clear therefore what the Federal Government's recent proposal to apply the MIS rules to litigation funding arrangements would achieve other than creating further costs and administrative hurdles which will delay, or in some cases prevent, class actions from being filed, ultimately to the detriment of group members. Additional costs inevitably reduce the amount received by group members.

(ii) As regards protection for claimants, group members, and defendants:

a. Judges are the inherent regulators of litigation funding in terms of protecting the valid interests of claimants and defendants. Judges understand the law, have access to the evidence, and have the tools necessary to not only determine whether the case has merit but also address misconduct through case management and costs orders. Judges can and do protect the interests of group members in class actions via their general case management powers and by exercising judicial power on critical class action issues (for example, scrutinising funding arrangements and notices, class definition and pleading issues, opt-out and registration and settlement) with group members' interests in mind. Indeed the ALRC recommended that instead of licensing funders, appropriate and effective consumer protection is best achieved through improving court oversight of third-party litigation funders on a case-by-case basis.[10]

b. Claimants are also protected by their solicitors and barristers who owe their fiduciary duties to them, not to the funder. Solicitors advise their client on the litigation funding agreement and ensure that the claimants are adequately indemnified from downside risk in the litigation from adverse costs. Those solicitors and barristers are each regulated by their own professional bodies.

[9] ALRC Report para 6.37
[10] ALRC Report para 6.42

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c. Balance, like other reputable overseas funders, is a member of both the Association of Litigation Funders of England and Wales (**ALF**), and the Association of Litigation Funders of Australia (**ALFA**). To be a member of the ALF, members must meet minimum capital adequacy requirements (as confirmed by an auditor) and maintain sufficient capital to meet 36 months of funding requirements. The ALF members also abide by a Code of Conduct which prevents arbitrary termination of funding agreements and provides a complaint procedure.

(iii) As regards the discriminatory effects against non-resident litigation funders:

a. There is an unfortunate "anti-foreigner" tone to some of the reporting on litigation funding in Australia and statements made in relation to regulation and taxation.[11] Balance is based in the UK, where our team resides and where all of our global investment and case management decisions are made. Balance's investments into Australian litigation are made by a dedicated UK company directly owned by our English domiciled fund. The UK company pays tax to the UK government on any profits, and our fund investors (which include Australian investors) are responsible for their own tax obligations in their home jurisdictions. The Australia-UK Double Tax Agreement (**DTA**) applies to our UK company, the DTA being a treaty entered into by Australia and the UK to encourage the flow of capital and investment between our two countries. Australian-based private equity companies investing in the UK, subject to the rules of the treaty, are treated in the same way – paying tax in Australia and not the UK. It would be discriminatory to apply one rule to litigation funders which represents a tiny proportion of the private equity market in Australia[12] and a negligible proportion of foreign capital inflows into Australia[13], and not to the entire private equity or investment sector. More funders operating in Australia means more competition, driving down commissions for claimants.

b. We currently have little visibility on what the regulations will look like save for a press release from the Treasury. If it transpires that funders like Balance will be required to apply and hold an AFS Licence, the extra costs and administrative burden will not provide protection to the stakeholders identified but it will give local Australian funders who already have such a licence (we understand that there are just two) an unfair advantage and could reduce competition. At the very least, any requirement to hold an AFSL should be phased in over a period of time to allow funders adequate time to make necessary arrangements to ensure minimal interruption to their investments into Australia given processing times at ASIC are generally between 150 and 240 days.[14]

Ultimately, it is not clear what the purpose of further regulation is and why it is necessary. The likely effects are that they will be to the detriment of claimants seeking litigation funding as some or all of the higher costs will inevitably end up being borne by those claimants. If the aim is to reduce the number of class actions being commenced, the only beneficiaries of that will be the multi-national corporations who have engaged in unlawful malfeasance, and who will take the benefit of having a key private enforcement mechanism stifled.

6 Balance has been misrepresented in the Australian media

Finally, and to correct the public record, we note that Balance was the subject of inaccurate reporting in March 2020 in The Australian newspaper. An article published on 27 March 2020 implied that Balance had conducted a recent capital-raising in order to opportunistically exploit the COVID-19 situation. This suggestion was false, and in fact our capital-raising was completed prior to the COVID-19 situation arising. However, The Australian

[11] Australian Industry Group - Innes Willox descr bes as "being driven by a flood of cash from unregulated overseas litigation funding firms". https://www.afr.com/politics/federal/crackdown-on-class-action-funders-20200521-p54va0
[12] Private Equity market in Australia is AUD 30bn. 2019 Yearbook: Australian Private Equity & Venture Capital Activity Report – Prequin – 29 May 2019
[13] Australia received US$62 billion in foreign direct investment (FDI) inflows in 2018. UNCTAD Investment Trends Monitor – January 2019. https://unctad.org/en/PublicationsLibrary/diaeiainf2019d1_en.pdf
[14] ASIC Service Charter – www.asic.gov.au/afslicensing

failed to issue a corrective statement despite a correction being sought from the journalist involved (who did not contact Balance prior to publishing his article). Unfortunately the false story was picked up and repeated by other publications such as LawyersWeekly, although those other news outlets subsequently corrected their online stories.

7 Conclusion

Litigation funding is a complex business. Funders have no incentive to invest in baseless or spurious claims. The Australian judiciary has all the tools necessary to protect all stakeholders. As found by the ALRC, Australia's funding and class action system levels the playing field for those seeking redress through the courts, and holds defendants to account, incentivising better business practices to the benefit of all. We urge the Australian Government to be slow to discard the findings of the ALRC and to disrupt the current system at the behest of a small group of business leaders and well-funded lobby groups.[15]

We look forward to an objective and data-driven debate, and trust that this submission is helpful.

Yours sincerely

Balance Legal Capital LLP

[15] *Inq* Report – David Hardaker - 26 May 2020 https://www.cr key.com.au/2020/05/26/how-class-action-warrior-christian-porter-created-legal-crisis/