SUBMISSION TO THE PARLIAMENTARY JOINT COMMITTEE ON CORPORATIONS AND FINANCIAL SERVICES ON LITIGATION FUNDING AND REGULATION OF THE CLASS ACTION INDUSTRY

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I provide a link to an Op-Ed, which was published on 27 May 2020 on *lawyerly.com*, (https://www.lawyerly.com.au/will-2020-mark-the-beginning-of-the-end-for-class-actions-in-australia) which summarises my views as to the announcements made last month by the Federal Government with respect to class actions and litigation funding and provides empirical data on various dimensions of Australian class actions that I have compiled since 2007.

LICENSING OF COMMERCIAL LITIGATION FUNDERS

I have nothing against the legislative regulation of any industry, including the litigation funding industry. But the introduction of any regulation must be shown to have a net beneficial effect: that is, its benefits must outweigh its costs. As I sought to show in the attached piece, both the Australian Law Reform Commission (ALRC) and the Australian Securities and Investments Commission (ASIC) concluded, persuasively in my view, that no such scenario would be secured through the removal of the exemptions that are currently enjoyed by litigation funders from holding an Australian Financial Services Licence (AFSL) and being characterised as a managed investment scheme.

These developments will prompt a number of litigation funders to leave the Australian class action market and might lead to an increase in the commissions charged by those funders that continue to fund Australian class actions. Thus, the only beneficiaries of these changes are those entities and persons that will not be on the receiving end of class action litigation despite allegations that they have acted unlawfully and caused losses and harm to seven or more similarly-situated claimants. Sadly, this appears to be the principal aim of some of the supporters of this type of reform.

My empirical research has revealed that right from the first class action supported by litigation funders (funded class actions) security for costs orders have been made in favour of respondents/defendants. I have identified only two class actions where the funders did not honour their financial commitments with respect to class action litigation. In neither of these cases did this negative development have any adverse effects on class members or the respondents.

HIGH SETTLEMENT RATE FOR FUNDED CLASS ACTIONS

The claim made by class action opponents that litigation funders have, more often than not, supported meritless class action litigation is totally contradicted by my empirical finding that approximately two out of every three concluded Australian funded class actions were ultimately resolved through judicially-approved settlement agreements. This percentage is even higher with respect to resolved federal funded class actions (over 72%).

The empirical data again contradicts the claim that litigation funders have regularly received outrageous or scandalous percentages of gross settlement funds paid by respondents/defendants in class actions. As recently explained by Justice Murphy of the Federal Court:

"According to the research of Professor Vince Morabito, the median funding rate in funded class actions settled in the federal jurisdiction in the period January 2013 to December 2018 was 26% of the gross settlement, and for all Australian class actions (not just in the federal jurisdiction) settled during that period the median funding rate was 25.5% of the gross settlement: V Morabito, 'An Evidence-Based Approach to Class Action Reform in Australia: Common Fund Orders, Funding Fees and Reimbursement Payments', Monash University, January

2019. Such median percentages are a good proxy for an objective standard of what commission may be appropriate: *Kuterba v Sirtex Medical Limited (No 3)* [2019] FCA 1374, [11] (Beach J)".[1]

I must confess that I am beginning to doubt the good faith of those who claim that the commission rates mentioned above are unreasonable, obscene or generate windfalls for litigation funders. Litigation funders invariably assume responsibility for all, or a significant portion, of the costs incurred in running class action litigation as well as a significant proportion of the costs incurred by their opponents, in the event of an unfavourable outcome.

COMMON FUND ORDERS

These median funding rates will keep going down if Common Fund Orders (CFOs) continue to be employed notwithstanding the December 2019 ruling of the High Court in *BMW Australia Ltd v Brewster.*[2] I reviewed all the CFOs that were made in federal class actions *at the settlement stage* in the period from 27 October 2016 - the day after the Full Federal Court endorsed the use of such orders in federal class actions in *Money Max Int Pty Ltd v QBE Insurance Group Ltd*[3] - to 3 December 2019, the day before the High Court's decision in *Brewster.* I discovered that the commissions paid to funders, pursuant to such orders, ranged from 8.3% to 30% of the gross settlement sums with the median commission rate being equal to 21.9% of the gross settlement sum.

The figure mentioned above confirms that, with respect, contrary to what the majority justices concluded in *Brewster,* CFOs benefit class members more than they benefit litigation funders. In March 2020, Justice Beach of the Federal Court eloquently made this point and, as a consequence, called for legislative intervention in this area:

"… flowing from *BMW Australia Ltd v Brewster*, I now have less flexibility to deal with commission rates. In my respectful view, this is something that the legislature should address sooner rather than later … Trial judges need flexible tools to regulate these funding arrangements and to tailor solutions to each individual case. And preferably that regulation should take place closer to the outset of proceedings rather than at the other end, particularly where competing class actions are in play".[4]

The major problem with the expenses sharing mechanism preferred by the majority justices in *Brewster* - the funding equalisation mechanism - is that "judges who have applied funding equalisation mechanisms appear to have assumed that they lack the power to modify [the funding commission rates]"[5] and nothing in the judgments handed down by the majority justices in *Brewster* suggests that this judicial belief is incorrect. On the contrary, as noted by one of the dissenting justices in *Brewster*, Justice Edelman:

"… the fund equalisation solution suffers from the difficulty that it involves no necessary assessment by the court of the reasonableness of the remuneration costs incurred by the group members who enter into contracts with a litigation funder. Without such assessment, the group members who did not enter contracts might have unreasonable and excessive remuneration costs imposed upon them in the process of equalisation with those members who might have entered contracts in a 'compliant' manner".[6]

ALRC'S RECOMMENDATIONS

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[1] *Rushleigh Services Pty Ltd v Forge Group Limited (in liquidation) (Receivers and Managers appointed)* [2019] FCA 2113, [54].
[2] (2019) 374 ALR 627.
[3] (2016) 245 FCR 191.
[4] *McKay Super Solutions Pty Ltd (Trustee) v Bellamy's Australia (No 3)* [2020] FCA 461, [34].
[5] Ibid [20].
[6] (2019) 374 ALR 627, [185] referring to Vicki Waye and Vince Morabito, "Financial arrangements with litigationfunders and law firms in Australian class actions" in William H van Boom (ed) *Litigation, Costs, Funding and Behaviour: Implications for the Law* (Routledge, London, 2017) 155, 193.

Thus, as aptly noted above by Beach J, legislative intervention is required to ensure that class action judges can continue to keep funding commissions to reasonable levels. The best way to secure this desirable outcome is by implementing a number of recommendations made by the ALRC. One recommendation was to provide the Court with an express statutory power to make common fund orders on the application of the class representative or the Court's own motion.[7]

The ALRC's recommendation 14, if implemented, will also strengthen considerably the ability and power of federal trial judges to ensure that the remuneration paid to litigation funder is not excessive. It provides that Part IVA should be amended to provide, among other things, that:

- litigation funding agreements with respect to federal class actions are enforceable only with the approval of the Court;
- the Court has an express statutory power to reject, vary or amend the terms of these litigation funding agreements; and
- Australian law governs any such litigation funding agreement, and the funder submits irrevocably to the jurisdiction of the Court.[8]

SUBSTANTIVE CLAIMS IN FUNDED CLASS ACTIONS

Attacks on the involvement of litigation funders in Australian class actions frequently focus on the fact that such entities are really only interested in one category of class actions, shareholder class actions. But again my most recent empirical data reveals the existence of a rather different scenario, one where less than half of the funded class actions were dealing with claims by shareholders. Furthermore, close to two-thirds of all funded class actions filed in the 2018-2019 financial year did not deal with the grievances of shareholders.[9]

CLAIMANTS AND SUBSTANTIVE CLAIMS IN ALL AUSTRALIAN CLASS ACTIONS

In a book chapter published in 2017 Justice Murphy and I provided a summary of the varied kinds of claimants and the diversity of the causes of action that had been brought pursuant to Australia's class action regimes. These have included disaster class actions; claims under the *Migration Act 1958* (Cth); personal injury through food, water or product contamination; personal injury through defective products; shareholder class actions; investor class actions; anti-cartel class actions; consumer class actions; environmental class actions; human rights class actions and employment class actions. This review prompted us to conclude that "the number of claimants, the variety of their claims, and the diversity in the types of people and entities who have had access to justice through the class action procedure shows that the regime allows substantial and broad-based access to justice".[10] Nothing that has happened in Australia's class action landscape since this chapter was published has in any way affected the validity of this conclusion.

In this chapter his Honour and I went through all the reviews undertaken by law reform commissions and similar independent bodies of Australia's class action regimes, since they were first introduced in Australia in the Federal Court in March 1992. What this analysis showed was that none of these reviews led to calls for restrictions on the operation of these regimes. On the contrary, a majority of

[7]Australian Law Reform Commission Integrity *Fairness and Efficiency - An Inquiry into Class Action Proceedings and Third-Party Litigation Funders* (Report, December 2018), [4.27] (Recommendation 3).
[8] Ibid [6.64].
[9] Vince Morabito, *Shareholder Class Actions in Australia – Myths v Facts* (November 2019), 16, available at https://ssrn.com/abstract=3484660.
[10] Honourable Justice Bernard Murphy and Vince Morabito "The First 25 Years: Has the Class Action Regime Hit the Mark on Access to Justice?" in Damian Grave and Helen Mould (eds) *25 Years of Class Actions in Australia 1992 - 2017* (Ross Parsons Centre of Commercial, Corporate and Taxation Law, University of Sydney, Sydney, 2017) 13, 28.

the recommendations stemming from these reviews were intended to enhance the ability of these regimes to secure access for justice for claimants.[11] This description also accurately captures the recommendations contained in the final reports of the Victorian Law Reform Commission and the ALRC released in 2018 with respect to class actions and litigation funding.

In an article published in 2016 Jarrah Ekstein and I reviewed the many class actions - not involving shareholders or investors and filed in the first 22 years of the availability of class actions in Australia - brought on behalf of vulnerable claimants.[12] These claimants included persons unable to commence individual proceedings to enforce their legal rights as a result of social, psychological, intellectual, age-related or health barriers. In other class actions, the vulnerability of some claimants stemmed from the loss or damage the subject of the class action litigation; for example, those who suffered injury in natural disasters or as a result of faulty medical practices. In other class actions, the claimants were vulnerable prior to their cause of action arising; for example, asylum seekers, people with intellectual disabilities and children. Since this study was published the filing of class actions on behalf of vulnerable class actions, as well as human rights class actions, has continued as shown for instance by the Manus Island class action and the Stolen Wages class action.

NO "EXPLOSION" IN CLASS ACTION LITIGATION OR SHAREHOLDER CLASS ACTIONS

As the data contained in the attached document shows, no balanced or objective assessment of the volume of class action litigation in Australia could possibly lead to the conclusion that there has been an explosion in the number of class actions filed in Australia. This conclusion is fortified by comparisons with several overseas jurisdictions.[13] The attached paper also highlights the fact that comparisons between the volume of class action litigation in different periods are only meaningful where the same number of class actions were in operation during the periods in question. It also highlights the fact that after 2018 there has been a decrease in the number of: (a) Australian class actions: (b) federal class actions; (c) Australian funded class actions; and (d) federal funded class actions.

My latest empirical report has revealed a similar trend with respect to shareholder class actions. In the 2016-2017 financial year shareholder class actions constituted 44.7% of all the class actions filed in Australia in those 12 months. This percentage went down to 42.8% in the following 12 months and 32.2% in the last financial year.

This report also revealed that the shareholders of 34 companies or groups of companies filed class actions in the period from 1 July 2014 to 30 July 2019. That provides **an annual average of only 6.6 companies or groups of companies** whose shareholders resorted to the class action device.[14]

In light of the information provided above, it can be confidently concluded that there has been no explosion of shareholder class actions in Australia either over the last 27 years or so or in recent years.

COMPENSATION RECEIVED BY CLASS MEMBERS

Opponents of class actions have conveniently placed the spotlight only on the remuneration of plaintiff solicitors and litigation funders in order to substantiate the "stock" criticism that only lawyers and funders benefit from class actions. As mentioned in the attached piece, I will soon be providing data as to the compensation received by class members from successful class actions. In the meantime I can draw attention to the fact that:

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[11] Ibid 15-18.
[12] Vince Morabito and Jarrah Ekstein, "Class Actions Filed for the Benefit of Vulnerable Persons - An Australian Study" (2016) 35 *Civil Justice Quarterly* 61, available at https://ssrn.com/abstract=2802460.
[13] Morabito, above n 9, 13.
[14] Ibid 16.

- At least $888,605,232 has been paid to at least 96,217 shareholders, as a result of settled shareholder class actions.[15]
- At least $400,754,310 has been received by 11,686 class members as a result of successful product liability class actions.[16] In the federal class actions filed with respect to the VW global emissions scandal, it is estimated that $120.7 million will be received by the owners of 42,500 vehicles.[17] It is also estimated that in the hip implants class actions approximately $80 million will soon be distributed to class members.[18]
- In my submission to the VLRC in 2018 I revealed that just over one billion dollars had been received by 28,300 class members in Victorian class actions.

CONTINGENCY FEES IN CLASS ACTIONS

The use of contingency fees in class actions has been recommended by the Productivity Commission, the VLRC and the ALRC. This is hardly surprising when one considers that they can potentially enhance access to justice for a greater number of claimants and provide a greater percentage of damages and settlement proceeds than is possible under funded class actions.

The Victorian Government is seeking to follow the advice of its own law reform commission in implementing, with respect to class actions in the State's Supreme Court, a contingency fee model. Any attempts by the Commonwealth Government to use the s 109 of the Commonwealth Constitution mechanism, to have the Victorian legislation in question (if enacted) declared unconstitutional, would be grossly unsatisfactory; but I could use far stronger language.

CONCLUSION

There is no objective basis for implementing any measures that will directly or indirectly restrict the ability of class actions to allow claimants to seek access to our courts with respect to their legal grievances. Attention should instead be placed on giving courts presiding over this type of litigation adequate powers to ensure that class members are treated fairly and receive adequate compensation in successful class actions.

[15] Morabito, above n 9, 18.
[16] See Julian Schimmel, Nina Abbey and Vince Morabito "Empirical and Practical Perspectives on the First 27 years of Product Liability Class Actions in Australia" in Brian Fitzpatrick and Randall Thomas (eds) *Cambridge International Handbook of Class Actions* (Cambridge University Press, London, 2020) (forthcoming)
[17] *Cantor v Audi Australia Pty Limited (No 5)* [2020] FCA 637, [153].
[18] Affidavit of Julian Schimmel, 14 June 2019, filed in NSD213/2011.