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Committee Secretary
Parliamentary Joint Committee on Corporations and Financial Services

Dear Committee Members

Public submission: inquiry into litigation funding and the regulation of the class action industry

Thank you for the opportunity to make a submission to the inquiry.

I am a barrister practising in Sydney. I have practiced in the area of class actions for about six years, including four years as a solicitor and two as a barrister. During that time I have acted in a number of class actions funded by litigation funders, funded by contributions from group members, and funded on a "no-win, no fee" basis.

1. What evidence is available regarding the quantum of fees, costs and commissions earned by litigation funders and the treatment of that income?

1.1 Professor Vince Morabito of Monash University maintains a comprehensive database in relation to this. According to his article *Common Fund Orders, Funding Fees and Reimbursement Payments* (January 2019), the median percentage of settlement funds consumed by funding fees in funded class actions was 25%.

1.2 In the time between 2016 and 2019 when common fund orders were possible, increased competition between litigation funders competing for the same actions put substantial downward pressure on commission rates. Before then it was common to see commissions of 30-35%. After, rates were commonly below 20%.

1.3 The impact of the High Court's decision in *BMW Australia Ltd v Brewster* [2019] HCA 45, abolishing common fund orders, has yet to be seen, but I suspect that it will result in significantly increased portions of settlements being awarded to funders. This is for two reasons.

1.4 *First*, funders will revert to the model of filing "closed" class actions where all of the group members are required to sign a funding agreement in order to join. Privately negotiated commission rates are generally higher than the rate that a court would allow.

1.5 *Second*, it will result in funders being willing to fund actions only where they are able to conduct a successful "book build". This will have the effect of reducing competition, which will in turn increase prices.

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2. The impact of litigation funding on the damages and other compensation received by class members in class actions funded by litigation funders

2.1 The majority of class actions funded by litigation funders would not have proceeded without funding. Further, funding allows cases to be prosecuted with the appropriate resources. Class actions are generally large and complex pieces of commercial litigation, and require significant finances to pursue. The defendants are invariably large and well-resourced. Plaintiffs who are unable to match the resources of their opponents tend to struggle to prosecute the claim effectively, meaning that they ultimately settle on much less favourable terms than they otherwise would have. I have been involved in unfunded class actions that settled for a fraction of the total losses suffered by the group, because the plaintiffs were not able to continue paying legal fees.

2.2 Accordingly, there are few if any class members who are worse off as a result of litigation funding than they would otherwise have been. A funded action must be viewed against the alternative, which is either no action at all or an underfunded action that is much less likely to succeed in recovering the group members' losses.

3. The potential impact of proposals to allow contingency fees and whether this could lead to less financially viable outcomes for plaintiffs

3.1 "Contingency fees", or percentage-based billing, is a method of charging legal fees and no more. Despite generating a great deal of hysteria, it is not inherently more problematic than other models, and it actually has several benefits.

3.2 Contingency fees give the lawyer a stake in the outcome of the litigation. If the client wins, the lawyer wins. The more the client wins, the more the lawyer wins. If the client loses, the lawyer loses. Thus, the lawyer's interests are effectively aligned with those of the client.

3.3 Some oppose contingency fees *because* they give the lawyers a financial stake in the litigation. But many lawyers already have a financial stake in the litigation. "No win, no fee" agreements are currently permitted, and it in fact would be impossible in practice to ban such arrangements, because many clients cannot afford to pay their legal fees unless they win the litigation. Acting for a plaintiff who cannot afford to pay fees is always "no win, no fee" to an extent. The only alternative would be for all legal fees to be publicly funded, or to permit only large companies and wealthy individual to litigate.

3.4 Once a lawyer runs the risk of not getting paid if the action does not succeed, the difference in incentives between contingency fees and "no win, no fee" is minimal, except that the contingency fees encourage the lawyer to get a better outcome for the client.

3.5 The most common method that lawyers use to charge fees is billing for time. That model incentivises lawyers to do unnecessary work, and to drag things out rather than resolve them quickly.

3.6 Another common billing method is fixed fees, meaning the lawyer gets paid the same amount regardless of how much work they put in and regardless of the outcome. Under

this model the lawyer is incentivised to minimise the work they put in, even if this achieves a worse outcome for the client.

3.7 Contingency fees better align the lawyers' interests with the client's interests than either hourly fees or fixed fees. They also create no more of a conflict of interest. There is no rational reason to ban lawyers from charging for the outcome that they achieve rather than the amount of time they spend getting there. The ban on contingency fees is an archaic and unjustified piece of regulation, and should be repealed.

4. The financial and organisational relationship between litigation funders and lawyers acting for plaintiffs in funded litigation and whether these relationships have the capacity to impact on plaintiff lawyers' duties to their clients

4.1 In my observation, for the most part litigation funders have a positive influence on lawyers conducting litigation. As sophisticated repeat litigants, funders are effective at overseeing the lawyers' performance while also ensuring that they stick to their budgets. Most class action plaintiffs and group members are not sophisticated litigants and are not able to provide effective oversight or instructions. They invariably do whatever they are advised to do. For example, I know of a few class actions where a litigation funder has "fired" the plaintiff's lawyers because of poor performance. I know of no cases where that has been done by an unfunded plaintiff, most of whom would neither know how to tell if the lawyers were underperforming, nor where to find replacements.

4.2 That is not to say that funders' influence is only ever positive. Sometimes funders and lawyers do pursue their own commercial interests to the detriment of the class members. It is true that lawyers can find it hard to say no to the funders who pay their bills. This can result in funders attempting to take a larger share of a settlement than they ought to be entitled. However, the courts are alive to this problem and have been increasingly willing to cut funding commission rates where it appears unjust: see, eg, *Petersen Superannuation Fund Pty Ltd v Bank of Queensland Limited (No 3)* [2018] FCA 1842. For the most part, court oversight is an effective means of mitigating the effect of funders taking advantage of the group members. As several Federal Court judges have commented, without common fund orders it will be less effective: see, eg, *McKay Super Solutions Pty Ltd (Trustee) v Bellamy's Australia Ltd (No 3)* [2020] FCA 461 at [32]-[34].

4.3 In larger settlements, the appointment of a contradictor can be an effective means of keeping the funders and lawyers in check: see, eg *Bolitho v Banksia Securities Ltd (No 6)* [2019] VSC 653. The costs make this unviable in smaller settlements.

5. The Australian financial services regulatory regime and its application to litigation funding

5.1 The Committee should be cautious before recommending increased regulation where it is not needed. Increasing the cost of regulatory compliance for litigation funders would inevitably stifle competition, to the benefit of the large established litigation funders and the detriment of the claimants.

5.2 It is true that litigation funders provide funding to large numbers of consumers. However, it generally comes at no real risk to the consumers. The funder agrees to fund the consumers' claims and provides a full indemnity against adverse costs. The worst possible outcome for the consumers is generally that they will lose the claim and recover nothing. But if the funder had not agreed to fund the claim that would probably have happened anyway. I know of no cases where the claimants have been left worse off than they started because of litigation funding.

5.3 Litigation funding is, in that respect, completely different from the financial services industries that are subject to large amounts of regulation. Unlike fund managers, insurers, and deposit-taking institutions, litigation funders do not take care of large amounts of money belonging to other people. Unlike banks and consumer credit providers, they do not hold loans secured against thousands of family homes. Unlike financial planners, they are not telling mums and dads where to put their retirement savings.

5.4 Further, as a general rule, the interests of the litigation funder are aligned with those of their customers. If the litigation succeeds, everyone gets paid. If it loses, everyone loses. Issues only arise when the action is somewhat successful, but less so than anticipated, meaning that there is a small pool of funds that everyone has to fight over. The solution to that problem is court scrutiny and the appointment of contradictors, not regulation.

5.5 If a poorly capitalised funder fails while it is funding a worthwhile piece of litigation in a competitive funding market, there will be another funder waiting to take over. If the industry is over-regulated then the funder will be much harder to replace. Again, the best solution is competition, not regulation.

5.6 Finally, while the Full Federal Court has found litigation funding scheme to fit the definition of "managed investment scheme" under the *Corporations Act* 2001 (Cth), the present regime for regulating managed investment schemes is extremely ill suited to litigation funding schemes. Litigation funders are not asset managers. The requirement for a fund to be managed by a public company has no relevant application, and neither do the disclosures that fund managers are required to give to prospective investors. If the Committee does see fit to remove the exemption (and I submit that it should not), there would need to be a substantial redesign of the system in order to ensure that it is fit for purpose.

6. The regulation and oversight of the litigation funding industry and litigation funding agreements

6.1 It should be recognised that litigation funding is not only used in class actions. It began as a product catering to the insolvency industry. Outside of class actions, litigation funders rarely if ever deal with consumers. Their customers are mostly sophisticated claimants capable of protecting their own interests.

6.2 Further, class actions are not only brought on behalf of consumers. They are often brought on behalf of institutional investors, municipal councils, and the like. Those entities are more than capable of looking after themselves.

6.3 That said, there are two aspects of litigation funding agreements that could benefit from regulation, but only where the funded party is a consumer. *First*, it should be required that every litigation funder gives a full indemnity to the plaintiffs or class members. *Second*, there should be a requirement for transparency in the fees charged under litigation funding agreements, to prevent the inclusion of hidden management fees and administration fees in addition to the "headline" commission rate.

6.4 Otherwise, the best protections against onerous funding terms are: (a) competition between funders; and (b) court scrutiny. Common fund orders increased both of these factors. Without common fund orders, it is likely that more onerous terms will start to creep back into funding agreements.

7. The application of common fund orders and similar arrangements in class actions

7.1 Common fund orders were a positive development for the Australian justice system.

7.2 The class action regime has two principal policy goals. First, to make it economically viable for large groups of people to bring claims which could not individually be brought. Second, to provide a more efficient means of bringing group claims, even where individual claims would otherwise be viable: see, *Wong v Silkfield Pty Ltd* [1999] HCA 48; 199 CLR 255 at [20].

7.3 Before common fund orders were available, litigation funders principally funded shareholder class actions where it was possible to sign up a few institutional investors each of which had a substantial claim in its own right. They also favoured "closed" classes, meaning that the class members had to sign a funding agreement in order to participate. For obvious reasons, the funders worked hardest at signing up the claimants with the largest claims (read: institutional investors). This meant that those who lost out were the small businesses and "mum and dad investors".

7.4 Common fund orders meant that litigation funders had an incentive to maximise the number of claimants. Claims were accordingly filed as "open classes" not "closed classes", and thus retail investors were included. It also made it more viable to fund claims other than shareholder claims, such as consumer class actions regarding defective car airbags, or overcharging of credit card fees or insurance premiums. In such cases, the claims are too small and the claimants too many for the action to be financially viable without a common fund order. The people who benefit from such actions are small businesses and consumers, and they are the real "losers" from the loss of common fund orders.

8. Factors driving the increasing prevalence of class action proceedings in Australia

8.1 To the extent that there has been an increase in recent years, it has been relatively minor: see, Vince Morabito, *Shareholder Class Actions in Australia - Myths v Facts* (November 2019). The factors driving the increase (to the extent it has occurred) include:

(a) the maturation of the system (bearing in mind that class actions have only existed in Australia since 1992);

(b) the expansion of the number of jurisdictions where class actions are available (Queensland and WA recently introduced class action regimes; NSW did so one a decade ago);

(c) media reports concerning the under-payment of workers, many of which have spurred class actions; and

(d) the Banking Royal Commission, which led to a number of class actions against banks and financial institutions.

9. What evidence is becoming available with respect to the present and potential future impact of class actions on the Australian economy

9.1 There is very little such evidence. There have been complaints from insurers about the cost of directors' and officers' liability insurance for publicly listed companies, but nothing I have seen rises above anecdotal evidence.

9.2 Any consideration of this issue must account for the effectiveness of class actions as a private enforcement mechanism that takes pressure away from regulatory agencies such as ASIC and the ACCC, as well as the benefit to the claimants and the wider economy of the funds recovered in class actions.

10. The effect of unilateral legislative and regulatory changes to class action procedure and litigation funding

10.1 The Commonwealth introduced class actions in 1992. Victoria followed in 2000. New South Wales did so in 2010. Queensland did so in 2016. Western Australia did so in 2019. Each of those jurisdictions acted unilaterally when they introduced the legislation. No one now questions the wisdom of those decisions. There is no serious push to abolish class actions federally or in any of the states that have adopted them.

10.2 To date, the other states and territories have yet to enact legislation enabling class actions. In my submission, whether they do is and should be a matter for them. Australia's federal system has functioned well over the past 120 years by permitting states and territories to adopt the judicial systems that they deem appropriate.

10.3 With that having been said, it may be worthwhile for the Council of Australian Governments to establish a working group to attempt to bring some uniformity to Australia's representative proceedings legislation. If a consensus position can be reached then it would no doubt be a positive development.

11. The consequences of allowing Australian lawyers to enter into contingency fee agreements or a court to make a costs order based on the percentage of any judgment or settlement

11.1 I have addressed the issue of contingency fees in response to term of reference 3. I will add that to the extent anyone submits that contingency fees should not be adopted because we want to avoid having an "American-style" justice system, this is a xenophobic argument without any substance. America has, on the whole, a very strong and highly regarded justice system. There is no empirical evidence indicating that Australia's system

is inherently superior to America's. Further, Australia's system has many other differences from the American system (such as the "loser pays" costs rule), and contingency fees or no we are not about to turn into America.

12. The potential impact of Australia's current class action industry on vulnerable Australian business already suffering the impacts of the COVID-19 pandemic

12.1 The vast majority of businesses in Australia stand to benefit from class actions. Class actions provide a means for small and medium size businesses, which otherwise would not have the resources, to enforce their legal rights against large companies or government bodies. Without class actions, small businesses would be significantly more vulnerable to misconduct by large companies and government bodies.

12.2 As I have noted, without common fund orders most participants in shareholder class actions are institutional investors, most of whom would have the resources to pursue litigation in any event. The ones that miss out are the "mum and dad investors" and small businesses. The same is true for non-shareholder claims. The people who benefit from class actions are mostly consumers and small businesses. During the COVID-19 pandemic, class actions provide an important protection for small businesses against being taken advantage of by banks, insurers, and other large players with significantly more bargaining power than the small businesses would have alone.

12.3 The only businesses that could be said to be "vulnerable" to class actions are large companies. The potential impact of class actions on those businesses is that if they do something that is probably illegal and it causes a large number of people to suffer loss, then those people might sue. It is not clear that this should be discouraged.

12.4 Most large companies are able to withstand a class action. Many have insurance. Class actions are rarely if ever the decisive factor in a company failing—where a company the subject of a class action becomes insolvent, there are generally other creditors circling.

13. Evidence of any other developments in Australia's rapidly evolving class action industry since the Australian Law Reform Commission's inquiry into class action proceedings and third-party litigation funders

14. Any matters related to these terms of reference

14.1 As a final comment, I again urge the Committee to be wary in recommending the introduction of unnecessary regulation, especially in response to submissions from people with obvious vested interests. Australia has more to gain from a competitive market for litigation funding services than it does from an over-regulated one favouring large incumbent players.

14.2 Please let me know if I may be of any further assistance to the Committee.

Yours faithfully

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