1. Introduction

Whilst this submission is provided in a private capacity, it is motivated by a desire to provide the Committee with number of insights based on my work as Presiding Commissioner on the Productivity Commission's (the Commission) public inquiry into Access to Justice Arrangements, the report of which was provided to the then Treasurer on 5 September 2014. I understand that the Commission has not contributed to this area of public policy since that time other than through the publication of justice data within its Review of Government Services workstream.

In addition to this inquiry, I have made submissions to inquiries conducted by the Australian Law Reform Commission (ALRC)[1] and the Victorian Law Reform Commission (VLRC)[2] as well at speaking at a number of conferences and seminars on some of the issues before the Committee.

I have been a Member of the Australian Institute of Company Directors since 2004 and a Fellow since 2014. I must stress that the views expressed here should not be attributed to any other organisation that I am associated with, or have been in the past, other than the various findings and recommendations of the Commission cited below.

2. The Productivity Commission Access to Justice Inquiry

On 21 June 2013 the then Assistant Treasurer directed the Commission pursuant to Parts 2 and 3 of the *Productivity Commission Act 1998* (Cth) to undertake an inquiry into "Australia's system of civil dispute resolution, with a focus on constraining costs and promoting access to justice and equality before the law"[3]. Commenting on the release of the final Inquiry Report the Law Council of Australia described the Inquiry as "the most comprehensive review of access to justice arrangements in Australia ever attempted".[4]

The terms of reference, contained in the Inquiry Report[5], covered issues ranging from the assessment of the cost of supply of, and demand for, the provision of legal services; the structure, training and regulation of legal professions; discovery; court charges and funding; legal aid and other forms of legal assistance; alternative dispute resolution; pro-bono services; the extent to which people cannot gain access to justice who do not qualify for legal aid, through to the data collection relating to the legal services sector and the justice system more broadly.

It is important to note that whilst criminal matters were not part of the terms of reference consideration of some civil matters, particularly in relation to the funding of legal assistance

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[1] https://www.alrc.gov.au/wp-content/uploads/2019/08/04_w_mundy.compressed.pdf
[2] https://www.lawreform.vic.gov.au/sites/default/files/Submission%208_Dr%20Warren%20Mundy_22-09-17.pdf
[3] Productivity Commission (2014a) *Access to Justice Arrangements,* Inquiry Report 75, Volume 1, 5 September, iv
[4] Law Council of Australia (2014) "Law Council welcomes release of Productivity Commission Report into access to justice", Media Report, MS#1416 4 December
[5] PC(2014a) iv-vi

and issues relating to vulnerable people or those with complex legal needs, and domestic violence, inevitably took the Commission into the criminal sphere.

The Commission's report is available on its website[6]. In making some 82 recommendations variously relevant to all levels of government, the judiciary and a range of other organisations the Commission lent the weight of its analysis to widespread concerns that Australia's civil justice system was "too slow, too expensive and too adversarial".[7]

Of primary relevance to the Committee's terms of reference is Chapter 18 *Private Funding of Litigation* of the Commission's Inquiry Report. This chapter addresses issues relating to "conditional fees" (where no legal fees are charged if an action is unsuccessful but an uplift percentage is added to normal fees in the event of success); "damages-based billing" (often known as contingency fees), class actions and litigation funding. Chapter 6 *Protecting consumers of legal services* and Chapter 7 *A responsive legal* profession may also be of interest to the Committee as they touch on the impacts of fees structures on the behaviours, and regulation of ethical conduct, of lawyers[8].

3. Access to justice benefits of class actions and litigation funding

Civil litigation is beyond the economic reach of most Australians – as noted above it is very expensive. The then Chief Justice of Western Australia, the Hon. Wayne Martin AC QC told the Commission in a public hearing in Perth:

> *The hard reality is that the cost of legal representation is beyond the reach of many, probably most, ordinary Australians … In theory, access to the legal system is available to all. In practice, access is limited to substantial business enterprises, the very wealth, and those who are provided with some form of assistance.*[9]

The vast bulk of civil proceedings are precluded from receiving legal aid funding. This can be because the type of matter, such as defamation, is not covered by legal aid but more usually the person fails the relevant means test. The Commission estimated that around 8 per cent of households had economic circumstances that met the relevant means test.[10] The Law Council of Australia observed

> *… restrictions on legal aid are now so severe that, in many jurisdictions, a substantial proportion of those living below the Henderson poverty line … will not satisfy the means test for legal aid eligibility.* [11]

The Commission coined the phrase "the missing middle" – a situation where due to available financial resources only the very rich and those poor enough to receive legal aid have the financial capability to access the courts. The Commission examined a range of approaches that could be pursued to improve access to justice for the missing middle including reforms

[6] https://www.pc.gov.au/inquiries/completed/access-justice/report
[7] PC (2014a) 2
[8] It is acknowledged that the charging practices of barristers and solicitors are very different. In this submission, the use of the term "lawyers" should generally be taken to mean solicitors.
[9] PC (2014a) 6
[10] ibid 20
[11] Productivity Commission (2014b) *Access to Justice Arrangements,* Inquiry Report 75, Volume 2, 5 September, 717

around self-represented litigants (Chapter 14), greater use of ombudsman, tribunals and other forms of alternative dispute resolution (Chapters 8, 9 and 10), unbundling legal services, legal expenses insurance and contingent loans for legal expenses (Chapter 19). The Commission also examined options for people to have some of the costs and risks of litigation transferred to others (Chapter 18). As mentioned above this is where the Commission considered the issues most germane to the Committee's inquiry which I address in some detail below.

There are a wide range of matters where people experience significant harm (economic or otherwise) but the costs of seeking redress are prohibitive, particularly when the potential costs of the defendant that the court might require the applicant to pay in the event of an adverse decision are considered. Often similar harm has been experienced by a number (sometimes a large number) of individuals. These circumstances are readily identified by economists as giving rise to a collective action problem. The problem is solved by the persons who have experienced harm acting collectively. By entering into a class action arrangement, the expected average cost of the action to each litigant is reduced and may become acceptable relative to the damages being sought. Thus, class actions can be seen as improving access to justice.

It should be noted that class actions generate public benefits beyond those received by the members of the class. The first is that the cost to the courts, and the time taken, in administering the class action is usually less than would be the case if each claim was brought individually.

Secondly, like all litigation, there may be precedents established by the courts which can be applied in future, therefore reducing the time taken for trials and in some cases removing the need for judicial determination. This is particularly important as many class actions are brought in relation to matters where regulators operate such as securities law[12], consumer protection[13] and environmental protection[14] or in matters relating to unlawfully applied government power such as the live cattle[15] and robodebt[16] matters. Not only do these cases provide useful precedents to be applied in the future by regulators, they provide people with an avenue for redress against other parties where regulators either have not tried or been unsuccessful *ex ante* in preventing harm.

Litigation funders can also contribute to the solution of the collective action problem. It maybe that the matters at hand are so complex or there is such a large number of affected parties that significant resources and skills are required to identify, organise and manage the litigation. Significant costs, such as expert reports and payment of lawyers, may be required during the course of the litigation which cannot be deferred until the outcome of the case is concluded. Thus, litigation funding contributes to improving access to justice.

[12] *TPT Patrol Pty Ltd as trustee for Amies Superannuation Fund v Myer Holdings Limited* [2019] FCA 1747
[13] *Gill v Ethicon Sàrl* (No 5) [2019] FCA 1905
[14] Kirsty Jane Bartlett & Anor v Commonwealth of Australia, Bradley James Hudson & Ors v Commonwealth of Australia, Gavin Smith & Ors v Commonwealth of Australia
[15] *Brett Cattle Company Pty Ltd v Minister for Agriculture* [2020] FCA 732
[16] Katherine Prygodicz & Ors v Commonwealth of Australia

4. The concerns about class actions

Concerns were raised with the Commission about the growth in litigation associated with class actions and litigation funding. These concerns remain with us today, typically coming from the same quarters, and no doubt are a substantial part of the motivation of the Attorney General's referral to the Committee and his predecessor's referral of similar matters to the ALRC.

It should be noted that the Commission formed its views on data available to it around late 2013 and early 2014. Resources do not permit me to analyse data since that time. I have however reviewed the statistical analysis under taken by the ALRC that is presented in Chapter 3 of its report.[17] Allowing for some minor differences in approach, the methodology and analysis set out in the ALRC report seems to be robust and a sound basis upon which to understand the incidence and nature of class actions in the period covered.

The Commission accepted that class actions around the time of its report constituted around 0.1 per cent of all civil claims in Australia.[18] The analysis of the ALRC reports that the share of filings in the Federal Court accounted for by class actions has risen from 0.3 per cent in 2012-13 to 0.7 per cent in 2017-18.[19] Looking at these data, my view is that the best interpretation of the data is that whilst the number of class action filings is increasing, class actions still constitute a very small proportion of the filings in Australian courts. These data, and that produced by others such as Allens Linklaters (cited elsewhere in this submission) and Professor Morabito, demonstrate that the Australian courts are not being swamped by class actions, even allowing for the fact that class actions are generally long lived and may be in court for several years.[20]

Whist class actions can be funded by members of the class, the majority of them are now not. Allens Linklaters suggest that currently around 60 per cent of class actions are funded by third parties[21], an increase from just over 20 per cent between 2005 and 2009 and around 35 per cent between 2010 and 2014[22]. This is broadly consistent with the ALRC's estimate of 78 per cent of class action filings in the Federal Court being funded.[23]

The growth in funded class actions in and of itself is not a cause of policy concern. On face, it may simply reflect improved access to justice outcomes as the community becomes more aware of this form of redress and the legal services industry innovates and becomes more able to fund more actions. It could, in principle, also reflect that conduct within the wider community is giving rise to a larger number of claims although I stress I have no evidence of this.

That said, a number of concerns were raised with the Commission in relation to funded class actions:

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[17] Australian Law Reform Commission (2018) *Integrity, Fairness and Efficiency – An Inquiry into Class Action Proceedings and the Third-Party Litigation Funders*, Final Report, ALRC Report 134, December, 69-88
[18] PC (2014b) 618
[19] ALRC (2018) 73
[20] ibid 73
[21] Allens Linklaters (2020), *Class Action Risk 2020*, 7
[22] Allens Linklaters (2015), *Class Actions: A Ten Year Survey,* 3
[23] ALRC (2018) 74 76

- *Class actions promote unmeritorious claims.* It is important to distinguish additional claims from increased unmeritorious claims. It seems unlikely the funders who invest significant resources in bringing claims will do so without a substantial prospect of success, especially in those cases where members of the class have been indemnified against adverse cost orders. The Courts provide a further level of scrutiny – superior courts rarely allow unmeritorious claims to run their course.

  It was suggested that high rates of settlement prior to trial, especially in relation to securities law matters, was evidence of unmeritorious actions despite the fact that class action settlement rates seem to be consistent with civil litigation more generally, around 97 per cent.[24] Given the defendants in such actions were sophisticated litigants, the Commission was unconvinced that defendants were paying "go away money". Rather, its preferred view that such settlements were an informed balancing of risks and costs.[25]

  The Commission also observed that such concerns seemed to be limited to securities class actions and suggested further investigation of whether there was a problem with the underlying securities law rather than the ability of aggrieved parties to bring funded class actions.[26]

  That said, the Commission found no evidence that funded class actions were leading to unmeritorious claims being brought. I am not aware of the ALRC or VLRC drawing different conclusions in more recent studies.

- *Litigation funders earn excessive profits.* The Committee will be aware of ongoing concerns regarding the fees being received by litigation funders.[27] These concerns were alive during the Commission's Inquiry. The evidence that was provided to the Commission suggested that at the time funders were recovering between 25 and 45 per cent of the proceeds of the litigation.[28] Evidence presented by the ALRC relating to matters completed in the Federal Court between 2013 and 2018 suggests the top end of this range may be higher.[29]

  At the time of the Commission's Inquiry credible academic sources suggested given the costs and risks incurred by litigation these levels were not unreasonable.[30] Further, more broadly, it is fair to say that increasing entry into the litigation funding market and potential competition from lawyers providing fees on a contingency basis, the Commission expected that there would be downward pressure on the fees received by litigation funders.

  Whilst the Commission recommended both the allowing of contingency fees to be charged by lawyers and for them to be subject to a percentage capping framework

[24] PC (2014b) 620
[25] ibid 620-621
[26] ibid 601
[27] The Hon Christian Porter MP (2020) "Committee to examine impact of litigation on justice outcomes", Press Release, March 5
[28] PC (2014b) 622
[29] ALRC (2020) 83-85
[30] For example, see Wayne Attrill (2012) "The Future of Litigation Funding in Australia" in Michael Legg (ed) *The Future of Dispute Resolution*, 1st Edition, 167 179

(discussed below) it did not recommend percentage capping of fees collected by litigation funders. The Commission reasoned

> *While there is likely to be some overlap, litigation funders provide a different service to lawyers — they provide funding and manage claims on behalf of clients rather than providing legal advice. As noted above, current commissions charged by funders appear commensurate to the services offered. Further, if a limit is imposed on lawyers using damages-based billing, then to some degree funders' fees will become constrained, as they would have to differentiate their service offering to justify charging higher amounts, a point noted by Maurice Blackburn.*
>
> *Therefore, the Commission considers that there is no need to place a limit on the fees of litigation funders.*[31]

Further class action settlements are subject to judicial oversight and determination. Whilst recommending capping for contingency fees, the Commission did not recommend the structure of such capping, whilst noting the wide range of practices of jurisdictions that allowed and regulated contingent fees.[32] Given the relatively low number of actions, and the wide range of matters they relate too, I suspect the construction of such scales would be largely arbitrary suggesting that more effective regulatory outcomes may be achieved via on-going judicial oversight and determination.

In summary, on the basis of the material before it in 2014 the Commission concluded, in relation to funded class actions, that it had

> *not received evidence that would lead it to believe these are current or likely future problems, or that the courts and regulators are not able to address problems if they emerge.* [33]

On the basis of the material that has emerged since that time, including but not limited to that produced by the ALRC and the VLRC, and given that the Government is implementing the Commission's recommendation to licence litigation funders, this remains my view.

Litigation funding provides access to justice to many Australians who otherwise could not bring civil claims and is worthy of on-going support from both the Parliament and the judiciary. As His Honour Justice Michael Lee noted recently in the settlement of claims against the Commonwealth in relation to ground water pollution emanating from RAAF bases at Oakey, Katherine and Williamtown

> *That without litigation funding, the claims of group members would not have been litigate in an adversarial way, but rather group members would likely have been placed in a situation of being supplicants requesting compensation in circumstances where they would have the subject of a significant inequality of arms.*[34]

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[31] PC (2014b) 635
[32] ibid 627-628
[33] ibid 601
[34] Ashley Eveleigh (2020) "'A significant inequality of arms': Funding let to better outcome in PFAS class action, judge says" *Lawyerly* https://www.lawyerly.com.au/a-significant-inequality-of-arms-funding-led-to-better-outcome-in-pfas-class-action-judge-says accessed 9 June 2020.

5. The Productivity Commission's recommendations for the regulation of litigation funders

The Commission made two recommendations in relation to litigation funders to enhance the protection of consumers using litigation funding services.

In the first, Recommendation 18.2, the Commission recommended:

> *The Australian Government should establish a licence for third party litigation funding companies designed to ensure they hold adequate capital relative to their financial obligations and properly inform clients of relevant obligations and systems for managing risks and conflicts of interest.*
>
> - *Regulation of the ethical conduct of litigation funders should remain a function of the courts.*
> - *The licence should require litigation funders to be members of the Financial Ombudsman Scheme.*
> - *Where there are any remaining concerns relating to categories of funded actions, such as securities class actions, these should be addressed directly, through amendments to underlying laws, rather than through any further restrictions on litigation funding.*[35]

The Commission, better than most, understands the competition impacts of unnecessary regulation but formed the view that licensing was necessary to ensure that the clients of litigation funders enjoy consumer protections similar to those enjoyed by consumers of other legal services; and that funders had adequate resources to meet their obligations to lawyers, experts and others, and to meet any adverse cost orders, in the event of an unsuccessful action. Further, given the financial services character of funders, the potential for overseas funders, and these matters primarily but not exclusively being brought in the Federal Court, licencing on the Commonwealth level is appropriate.

At the time the Commission reported, there was uncertainty surrounding the future roles of the Australian Securities and Investment Commission (ASIC) and APRA arising from the recommendations of the Murray Inquiry and so the Commission did not nominate a licensing body. It would seem to me now that this uncertainty has been resolved and given the failure of any given funder is highly unlikely to have a systemic impact on the financial system, ASIC is the appropriate regulator.

It was in large part a result of this institutional uncertainty that led the Commission to describe the characteristics of an appropriate licence rather than specify a particular existing licencing framework, namely the Australian Financial Services Licence (AFSL). It is my strong view that in the absence of the uncertainty mentioned above the Commission would have recommended litigation funders hold an AFSL as it did in its draft report.[36]

[35] PC (2014b) 633
[36] ibid 631

Recommendation 18.3 was directed at the Courts:

> *Court rules should be amended to ensure that both:*
>
> - *the discretionary power to award costs against non-parties in the interests of justice; and*
> - *obligations to disclose funding agreements*
>
> *apply equally to lawyers charging damages-based fees and litigation funders.*[37]

My understanding is that such orders are currently available in those jurisdictions where class actions are allowed. Whilst, damages-based fees remain unlawful, it appears that these this recommendation was supported by the VLRC and I expect will be taken up by the Victorian Courts once legislation permitting this bill practice is permitted.[38]

6. Contingency fees

"Contingency fees" (or as the Commission preferred to describe this approach "damages-based billing") involve the lawyer is paid a percentage (on a fixed or sliding scale) of the proceeds of the litigation in the event of success and in the event of failure, the lawyer receives nothing from its client. The client remains liable for its other costs and adverse cost orders in the event of defeat, but may receive costs from the opponent in the event of success.

The percentage received by the lawyer in the event of success compensates the lawyer for the work done, for financing the litigation, and the risk associated not receiving any fees in the event the litigation is unsuccessful.

Contingency fees are currently prohibited in all Australian jurisdictions although the Victorian Government, on advice from the Victorian Law Reform Commission, has indicated an intention to legislate to allow contingency fees.[39] At the time of the Commission's report, this approach to billing was permitted in a number of countries including the United States, Finland, Italy, Japan, Canada and the United Kingdom.[40]

Damages based billing improves access to justice in a way similar to litigation funding. First, it reduces the cost of the litigation in the event of failure as the litigant, whilst remaining exposed to an adverse cost order and other own costs (such as experts fees), will not have to pay their lawyer. Second, the lawyer effectively finances the litigation until the end of the proceeding removing the need of the litigant to make payments during the course of the litigation from what might their scarce resources. Thirdly, the prospect of higher fees under damages based billing may induce some lawyers, depending on their risk appetite and ability to finance the litigation and bear losses, to take on matters which otherwise would not be litigated.

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[37] ibid 637
[38] The Hon Jill Hennessy MP (2019) "Improving Access to Justice for Class Actions", Media Release, 28 November
[39] ibid
[40] PC(2014b), 606

There are concerns regarding damages based billing however the Commission found them not to be a sound basis to recommend the continuation of the prohibition, especially if the more general consumer protection reforms for users of legal services that it recommended in Chapter 6 of the report were put in place. Those concerns broadly were

- *Litigants are encouraged to pursue 'weak' or unmeritorious cases because they do not pay lawyers' fees in the event of loss*. However, lawyers — facing the risk of not being paid if the case is lost — have a strong financial incentive to reject cases with low prospects of winning. Further, as a result of Australia's cost-shifting rule, irrespective of the lawyers' fee structure, litigants are also discouraged from pursuing unmeritorious claims because they still pay disbursements and face the threat of paying a substantial proportion of the other side's legal fees and other costs if they are unsuccessful.
- *Lawyers profit excessively*. Given the prohibition on damages-based billing in Australia, there is no evidence to test this proposition. However, the Commission did not receive evidence that this was an issue in other jurisdictions nor did it find excess profits flowing to litigation funders who use a similar billing model. Further, with an appropriately structures capping arrangement as discussed below, the risk of this should be able to be reduced to an acceptable level.
- *Damages based billing creates conflicts of interest*. Much of the concern here related to perverse incentives being created that might lead to lawyers making choices in the management of the litigation process in order to save money contrary to the interests of the client. Indeed, the Australian Institute of Company Directors suggested damages based billing might "*undermine the well-respected integrity of the legal profession.*"[41] On the first point, the Commission was of the view that by better aligning legal fees with the cost of the litigation, the cost of the litigation may be reduced.[42] On the second, the Commission was generally of the view the supervision of lawyers by the Courts and ethical standards bodies was sufficient to remove the need to interfere with the freedom of contract between legal services providers and their clients.[43]

Indeed, the Commission reasoned that damages-based billing may provide some further benefits. First, it may create some competition for litigation funders. Second, it benefits claimants by providing an upfront assurance that legal fees will be commensurate to the value of taking legal action — prohibition on damages–based fees is contrary to proportionality which is a key goal of an effective civil justice system. Third, as a regulatory tool, prohibition and the associate interference with the freedom to contract should only be used as a last resort — where there are insurmountable risks associated with an activity that far exceed its benefits. And finally, banning particular forms of billing can inhibit pricing innovation — potentially prohibiting firms and clients from using the billing option that best reflects the value of services provided and the circumstances of the client.[44]

As noted in the above discussion of litigation funding, in those jurisdictions that allow damages-based fees there is usually a cap on the percentage of the proceeds that the lawyer may claim. A single percentage limit is generally not used as it does not provide adequate protection for consumers because lawyers' fees increase proportionately with the size of the

[41] ibid 626
[42] ibid 614-615
[43] ibid 636
[44] ibid 625-626

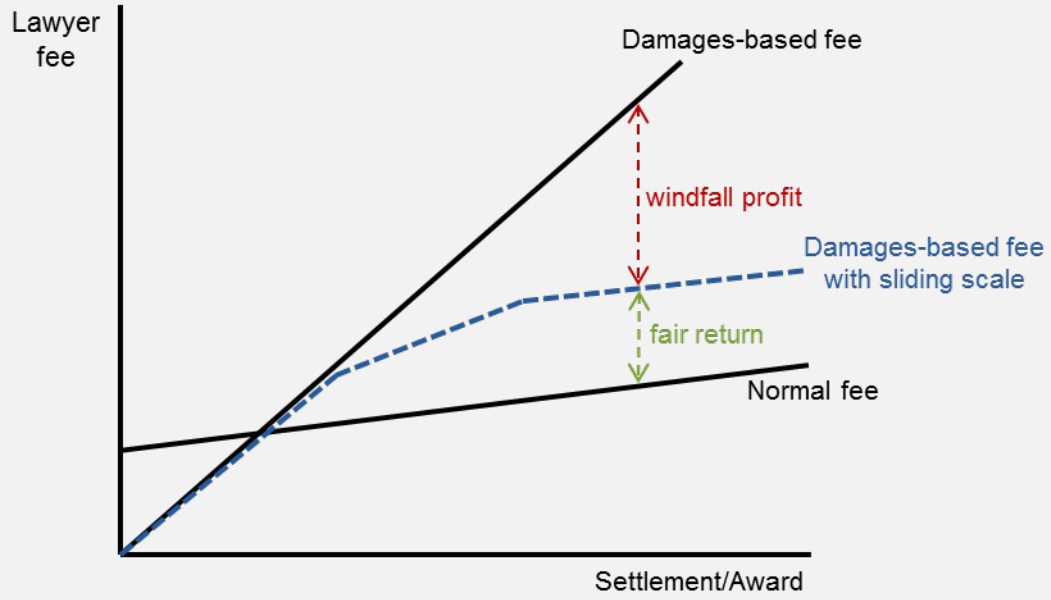
settlement or award and so does not prevent lawyers earning excessive or 'windfall' profits on high value claims. To address this concern, percentage limits are generally set on a sliding scale, where the percentage limit progressively drops as the settlement or award increases.[45] The Commission's explanation of this is contained in the following box.[46]

Percentage limits on a sliding scale

Normal fees, based on the lawyer's hours, tend to increase at a slower rate than the award or settlement, while damages-based fees, by their nature, increase proportionally with the settlement or award. The diagram below depicts the divergence in fees that can occur as the settlement or award increases — which can potentially create windfall profits for lawyers on high value claims.

Windfall profits can be avoided by imposing percentage caps on a 'sliding scale' — an upper percentage limit on fees that reduces as the amount recovered increases. Such a scale tapers the growth of the lawyer's portion of any settlement or award. While the lawyer's payment still increases, it does so at a progressively slower rate as the size of the settlement or award increases. This ensures lawyers' fees for large claims are not excessive relative to their costs.

That said, some extra profit relative to normal fees is warranted, analogous to the uplift fee for conditional billing. Ideally, the sliding scale needs to balance curtailing windfall profits while allowing a fair return for the lawyer, including interest for delaying the payment of fees and compensation for the additional risk borne. The compensation for risk should reflect a spread of wins and losses across a firm's overall caseload.



[45] ibid 627-628
[46] ibid

Taking this together, in its Recommendation 18.1 the Commission proposed substantial reform:

> *The Australian, State and Territory Governments should remove restrictions on damages-based billing (contingency fees). This recommendation should only be adopted subject to the following protections being in place for consumers:*
>
> - *the prohibition on damages-based billing for criminal and family matters, in line with restrictions for conditional billing, should remain.*
> - *comprehensive disclosure requirements — including the percentage of damages, and where liability will fall for disbursements and adverse costs orders — being made explicit in the billing contract at the outset of the agreement.*
> - *percentages should be capped on a sliding scale for retail clients with no percentage restrictions for sophisticated clients.*
> - *damages-based fees should be used on their own with no additional fees (for example, lawyers should not be able to charge a percentage of damages in addition to their hourly rate).*[47]

I would suggest to the Committee that this recommendation is broadly consistent with the reforms proposed by the Victorian Government in this area.

[47] ibid 629