Investor Claim Partner Pty Ltd

Submission to the Parliamentary Joint Committee on Corporations and Financial Services

Corporations Amendment (Improving Outcomes for Litigation Funding Participants) Bill 2021

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Introduction

1 Investor Claim Partner Pty Ltd (**ICP**) welcomes the opportunity to make this submission to the Committee's inquiry into the *Corporations Amendment (Improving Outcomes for Litigation Funding Participants) Bill 2021* (**Bill**).

2 I am the Chief Executive Officer and founder of ICP, Managing Director of ICP Capital Pty Ltd (**ICP Capital**), ICP Funding Pty Ltd (**ICP Funding**) and the Chair and co-founder of the Association of Litigation Funders of Australia.

3 In 1996, I founded Insolvency Management Fund Pty Ltd (**IMF**) to fund insolvency claims around Australia. In 2001, I co-founded and was an inaugural director of IMF (Australia) Ltd (now Omni Bridgeway Ltd) and remained a director until 2015 (being the Managing Director between 2004 and 2008). In 2016, I founded ICP and in 2017, 2018 and 2020, I founded ICP Capital, ICP Funding and CASL Governance Ltd, respectively, to predominantly fund class actions.

4 ICP has serious concerns with the operation and effect of the Bill:

(a) **Access to justice.** The presumption in favour of a minimum 70% distribution of 'claim proceeds' to scheme members, and the uncertainty the Bill creates for funders about their expected returns, is likely to discourage the funding of many meritorious claims, with a significant impact on access to justice in Australia.

(b) **Limiting the Court's discretion.** The Bill inappropriately limits the factors the Court may consider when approving the distribution of proceeds under a litigation funding agreement, and would enable a future government to amend those factors by regulation after a proceeding had commenced, even if it were a defendant to the proceeding.

(c) **'Closed' class actions.** The Bill will encourage 'closed' class actions, with negative consequences for the efficacy of the class-actions regime, and it fails to resolve the current uncertainty about the validity of common fund orders.

(d) **Impact on State Courts.** It appears the Bill would prevent funded class actions from being run in a State Court not exercising federal jurisdiction, unless equivalent legislation is enacted by the State. There is a real question whether this is constitutionally permissible.

(e) **Other constitutional and inconsistency issues.** Insufficient consideration has been given to other constitutional issues and to whether the Bill is inconsistent with the existing Commonwealth and State class action regimes. These issues require proper consideration before the Bill proceeds further.

Consultation process

5 The period for consultation on the exposure draft of the Bill was only one week (which included a holiday long weekend) and many of the submissions to that consultation expressed the concern that this period was insufficient. Similarly, the period for submissions to be made to this Inquiry is only one week. This period is wholly inadequate to consider and address the complex issues arising from the Bill.

6 The inadequate consultation and rushed preparation of the Bill is evident from its drafting errors, the apparent confusion about basic aspects of funded class action litigation, and the discrepancies between the Explanatory Memorandum and the text of the Bill itself. These discrepancies are liable to create further confusion and uncertainty about the Bill's operation and, if enacted, will drive up legal costs while the Courts seek to resolve these issues.

Court approval of the claim proceeds distribution method

7 The Bill will establish a new category of managed investment scheme under Chapter 5C of the *Corporations Act 2001*(Cth), referred to as a 'class action litigation funding scheme'. The stated aim of the Bill is to provide for the 'fair and reasonable' distribution of proceeds of such schemes as between scheme members and non-members, e.g. the funder and the lawyers.[1] The Bill ostensibly operates by making the 'claim proceeds distribution method' (**CPDM**) in a litigation funding agreement unenforceable unless it is approved by the Court as fair and reasonable, or varied by the Court so that it is fair and reasonable. There is a rebuttable presumption that a CPDM will not be fair and reasonable if more than 30% of the 'claim proceeds' are to be distributed to the non-members.

8 ICP supports the aim of achieving fair and reasonable distributions from the proceeds of funded class action litigation. However, the Bill fails in this primary objective and is instead liable to lead to unfair and unintended outcomes.

9 The new s 601LG(3) inappropriately limits the factors which the Court may consider when determining whether the CPDM is 'fair and reasonable'. ICP strongly opposes fettering the Court's discretion in this way – if the aim is to ensure a fair and reasonable distribution, the Court must be able to consider all matters that are relevant to the issue.

10 Relevant factors which the Court is not permitted to consider under s 601LG(3) include:

(a) The distribution to scheme members as a proportion of their best-case recovery. This is a key factor currently considered by the Court when approving class action settlements,[2] and its absence could lead to perverse outcomes.[3]

(b) The funding commission that scheme members have agreed to pay under the litigation funding agreement. Some deference should be given to scheme members' choices and their freedom to contract, particularly where the group members include sophisticated, repeat participants in class actions, and where litigation funding could not have been obtained on terms other than those agreed.

(c) The costs incurred by the defendant. Litigation funding 'levels the field' between class action plaintiffs and well-resourced defendants. A regime for the approval of CPDMs that does not allow consideration of the defendant's costs expended in the proceeding will discourage the proper resourcing of plaintiff's claims and ultimately lead to inferior outcomes for group members.

11 This issue is not overcome by s 601LG(4), which reserves the ability to amend the factors that the Court may consider under s 601LG(3) by regulation. Unfairness in a particular case cannot be overcome by a later regulatory amendment. Further, this provision grants a power to future governments to control the distribution of claim proceeds in a class action in which they may be a defendant. The mere existence of such a power is likely to have a chilling effect on meritorious class actions brought on behalf of persons wronged by government. Whether or not that is the Bill's intention, it is not something that should be endorsed by the Parliament.

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[1] Explanatory Memorandum, [1.16]. While not expressly stated, it is apparent that the Bill is concerned with the distribution of scheme proceeds as between scheme members and the funder and the plaintiff's lawyers, rather than as between funded group members and unfunded group members. However, the lack of clarity in the term 'entities who are not members of the scheme' is apt to create confusion.

[2] *Williams v FAI Home Security Pty Ltd (No 4)* [2000] FCA 1925; 180 ALR 459 at [19]; Class Actions Practice Note (GPC-CA), [15.5(h)].

[3] *Evans v Davantage Group Pty Ltd (No 3)* [2021] FCA 70 at [65], where although group members received 37.4% of the gross settlement sum, this equated to almost 100% of their claims. It appears doubtful that a CPDM which provides for such an outcome could be approved as fair and reasonable under s 601LG.

12 Although s 601LG(2)(b) provides that the proceeding only needs to be 'sufficiently progressed' before a CPDM can be approved, the practical reality is that task will only be undertaken by the Court once a settlement has been agreed or judgment has delivered.[4] Until that time, the CPDM will be unenforceable, creating real uncertainty about the likely return to the funder throughout the proceeding. Such uncertainty is likely to discourage the funding of meritorious class actions where the commercial viability is marginal, reducing access to justice, and will heighten the perverse incentives for early settlement created by the Bill, discussed further below.

Presumption in favour of a minimum 70% distribution of 'claim proceeds' to scheme members

13 ICP opposes the introduction of a presumption that a CPDM will not be fair and reasonable if non-members, including the funder and lawyers, will receive more than 30% of the 'claim proceeds': s 601LG(5).

14 ICP has previously made submissions to the Government as to the undesirability and unintended consequences of legislating a minimum return to group members from class action proceeds.[5] Of primary concern is that such a minimum will make many meritorious and valuable claims uneconomic for a litigation funder to support. Analysis conducted by PwC of recent class action settlements found that a 30% cap on total costs and commissions would have had adverse impacts in 91% of the cases.[6]

15 In the Bill, the 30% cap is expressed as a rebuttable presumption, rather than a statutory maximum. However, uncertainty about how the presumption may be rebutted, coupled with the limits on the Court's discretion when approving a CPDM under s 601LG(3), means the presumption is likely to have the same effect of discouraging the funding of many meritorious claims. This would have profound implications for access to justice in Australia.

16 Underpinning the proposed presumption is an unfounded view that the proceeds of class actions are 'inappropriately skewed' in favour of litigation funders at the expense of group members.[7] This view is unsupported by any empirical evidence and pays no regard to the material risks adopted by litigation funders, including the risk that they will lose their investment if the proceeding is unsuccessful. **Annexure A** to this submission provides details of a number of loss-making funded class actions.

17 Further, the presumption will create perverse incentives in the conduct of those proceedings that are still funded. It will encourage defendants to run "scorched earth" defences, to maximise the costs incurred on behalf of the plaintiff, knowing that at a certain point the rebuttable presumption may cause the action to become commercially unviable, creating settlement pressure. Conversely, the Bill will incentivise the plaintiff's lawyers and funder to minimise legal costs and obtain a settlement at an early stage, to ensure a reasonable recovery for themselves under the 30% cap, even if this may not maximise the overall return to the members. As noted above, the best recovery that members might have obtained had the matter been run differently is not something the Court is permitted to consider under s 601LG(3).

18 There are further practical issues that arise from the proposed definition of 'claim proceeds' in the Bill, which includes any award or agreement to pay legal costs in favour of the members:

(a) The definition would appear to capture settlements entered into by individual members directly with the defendant. Under the Bill, it will be necessary to account for such individual

[4] This is clear from the factors the Court must consider under s 601LG(3), many of which will only be known at that time.
[5] ICP, Submission to Treasury, Consultation Concerning Guaranteeing a Minimum Return of Class Action Proceeds to Class Members (25 June 2021).
[6] PwC, *Models for the regulation of returns to litigation funders* (16 March 2021), at 14-17.
[7] PJCCFS Report, [5.24].

settlements before the CPDM can be approved, creating serious practical impediments to the settlement of class actions.

(b) Where costs are awarded following trial, the quantification of those costs will frequently be the subject of assessment. As costs awarded or agreed in favour of the plaintiff fall within the definition of 'claim proceeds', the assessment of these costs will need to occur before the CPDM can be approved by the Court. In complex group litigation, this process could take years, significantly delaying the distribution of claim proceeds to members.

19 These practical issues, which are not addressed in the explanatory material, suggest a rushed and poorly considered legislative intervention into a complex and well-established area of law.

Proceedings in State Courts exercising non-federal jurisdiction

20 The proposed ss 601LF(1) and (4) provide that a CPDM will be unenforceable if the underlying proceeding is brought in a State Court not exercising federal jurisdiction, unless the Court approves the CPDM under powers or procedures that are '*substantially similar to those in section 601LG*'.

21 These provisions would constitute an extraordinary intervention by the Commonwealth in the operation and conduct of litigation in State Courts. What '*substantially similar*' means in this context is unclear. However, there is no provision in any State legislation that is equivalent to the proposed s 601LG. It appears the intended effect is to prevent funded class actions being commenced in a State Court exercising non-federal jurisdiction, unless the State enacts equivalent legislation.

22 There is a real question whether such an exercise of federal legislative power would be constitutionally valid.[8]

Discouraging 'open' class actions and common fund orders

23 The Bill defines a 'member' of a class action litigation funding scheme as a claimant who agrees in writing to be a member of the scheme and to be bound by the scheme's constitution. The Explanatory Memorandum states at [1.35] that this "*ensures that a claimant cannot be co-opted into becoming a member of the scheme [sic] litigation funding scheme… without their active consent*". This statement reflects a basic misunderstanding of the operation of litigation funding and the 'opt out' model of Australian class action regimes.

24 Under the current law, a class action may be commenced on behalf of a person (a group member) without them taking any active step in the litigation, and that person has a right to opt-out of the proceeding.[9] However, that person will not become a member of a *litigation funding scheme* or liable to make any payment under a funding agreement without their consent. A person may choose to enter a funding agreement, but they cannot be '*co-opted'* to do so.

25 In a 'closed' class action, typically the proceeding is commenced only on behalf of persons who have entered into a funding agreement with the litigation funder, i.e. the scheme members and the group members will be the same. In an 'open' class action supported by a litigation funder, the proceeding may be brought on behalf of the members of the litigation funding scheme as well as other group members who are not members of the scheme.

26 Open class actions facilitate access to justice and complement the principles underpinning the Australian 'opt-out' class actions model, by allowing all potential claimants to benefit from the

[8] See, e.g. *Melbourne Corporation v Commonwealth* (1947) 74 CLR 31.
[9] E.g. *Federal Court of Australia Act 1976* (Cth), ss 33C, 33E, 33J.

proceeding. Open class actions also benefit defendants by giving them the opportunity to finalise all claims arising from a particular event. Closed class actions are liable to generate a multiplicity of proceedings and do not offer defendants finality.

27 It is not apparent that the Bill is intended to mandate that funded class actions can only be brought on a closed basis. However, the effect of the Bill will be to encourage funded proceedings to be brought on a closed basis, to the detriment of the efficacy of the class actions regime:

(a) Contrary to the recommendations of the ALRC and this Committee,[10] the Bill fails to resolve the uncertainty about the Court's powers to make common fund orders (**CFOs**), which has persisted since *Brewster*.[11] The continued risk for funders that CFOs are ultimately found not to be available will encourage funders to prefer closed class actions, i.e. where all group members are also members of the scheme.

(b) The Bill also discourages the practice, common prior to the development of CFOs, of a funder who has signed-up a sufficient number of funded group members issuing proceedings on an open basis on behalf of all potential claimants, and then seeking a funding equalisation order (**FEO**) to share the funding costs across the whole group. Contrary to the apparent intention of the Bill, the definition of 'common fund order' in s 601LF(2)(c) will capture what is traditionally understood to be an FEO.

Other constitutional issues and inconsistency with existing class action regimes

28 There are further constitutional questions that arise in relation to the Bill, including whether there is a source of Commonwealth legislative power to support parts of the Bill, and whether the Bill may contravene Chapter III of the *Constitution*.

29 There are also valid questions as to whether the Bill would operate as an implied repeal of parts of Part IVA of the *Federal Court of Australia Act 1976* (Cth) and/or would render inoperative parts of the State class action regimes pursuant to s 109 of the *Constitution.* For example, the regime for Court approval of CPDMs under the Bill appears inconsistent with the Court's broad discretionary powers under the existing class action regimes in relation to the approval of class action settlements.[12] Relatedly, it is uncertain how the Bill could be reconciled with the 'group costs order' regime recently enacted in s 33ZDA of the *Supreme Court Act 1986* (Vic).

30 It is not apparent from the Explanatory Memorandum that any serious consideration has been given to these questions in the preparation of the Bill.

Conclusion

31 In light of these serious deficiencies in the Bill and the inadequate consultation prior to its introduction, the appropriate course is for a further proper consultation and review of the Bill and, if its deficiencies cannot be addressed, for the Bill to be withdrawn. I would welcome the opportunity to provide further submissions to the Committee at the public hearing to be held on 12 November 2021.

John Walker
Director
Investor Claim Partner Pty Ltd

5 November 2021

[10] ALRC Report, Recommendation 3; PJCCFS Report, Recommendation 7.
[11] *BMW Australia Ltd v Brewster* [2019] HCA 45.
[12] E.g. *Federal Court of Australia Act 1976* (Cth), ss 33V and 33ZF.

Appendix A – Loss-making Funded Cases Actions

Case No.	Investment Period	Lost Investment	Adverse Costs Paid	Total Loss
1	6.2 years	$10,289,303	$13,232,500	$23,521,803
2	4.7 years	$11,272,908	$10,000,000	$21,272,908
3	3.9 years	$15,279,652	$4,000,000	$19,279,652
4	5.2 years	$8,695,901	$8,417,901	$17,113,802
5	2.1 years	$5,225,000	$1,250,000	$6,475,000
6	5.3 years	$6,358,812	TBD	$6,358,812
7	3.0 years	$5,750,000	-	$5,750,000
8	3.1 years	$3,417,629	-	$3,417,629
9	1.8 years	$1,234,369	-	$1,234,369
Totals	**4.4 years average**	**$67,523,574**	**$36,900,401**	**$104,423,975**