Ai GROUP SUBMISSION

Treasury and Attorney-General's Department

Guaranteeing a minimum return of class action proceeds to class members

28 June 2021

Introduction

The Australian Industry Group (**Ai Group**) welcomes the opportunity to make a submission on the issues raised in the Consultation Paper *Guaranteeing a minimum return of class action proceeds to class members*, prepared by the Treasury and the Attorney-General's Department.

Class actions have a genuine role to play in ensuring that where a large number of parties have suffered common harm or damage, they are properly compensated. However, the current poorly regulated system is allowing litigation funders to take a disproportionate share of the amount ultimately awarded by a Court or of the settlement sum.

A recent Australian Law Reform Commission report on class actions proceedings and third-party litigation funders reported that in cases involving litigation funders, the median return to plaintiffs was only 51 per cent of the amount awarded, while in cases not involving litigation funders, the median return to plaintiffs was 85 per cent.[1]

There is an urgent need for appropriate legislative and regulatory amendments to ensure that the class action regime is not misused as an avenue for litigation funders to make unreasonable profits at the expense of businesses and class members.

Ai Group made a detailed submission to the Parliamentary Joint Committee's Inquiry into Litigation Funding and the Regulation of the Class Action Industry (**PJC Inquiry**).[2] In that submission, Ai Group urged the Committee to recommend that Parliament introduce a number of reforms aimed at preventing the misuse of the legal system by litigation funders pursuing unfair windfall profits. The reforms that we proposed included imposing reasonable limits on returns to litigation funders. As articulated in our submission, group members are entitled to a fair proportion of any settlement or awarded sum.

Ai Group supports the approach of imposing a reasonable limit on returns to litigation funders, by instituting a statutory minimum return of 70% of the gross proceeds of a class action to class members. However, in some contexts, a 70% return would be excessive, therefore, statutory criteria should be implemented to guide the Court in determining whether the minimum 70% gross return to class members is appropriate in a particular case or whether, for example, an 80% or 90% return to class members is appropriate.

The implementation of a minimum return to class members should be complimented with other reforms to increase protections for class members, including:

- The implementation of an 'opt-in' or closed class action system; and

[1] Australian Law Reform Commission, *Integrity, Fairness and Efficiency—An Inquiry into Class Action Proceedings and Third-Party Litigation Funders* (Final Report), December 2018. Published in Parliament on 24 January 2019.

[2] Australian Government, Parliamentary Joint Committee on Corporations and Financial Services, 'Litigation funding and the regulation of the class action industry' (Ai Group Submission) 15 June 2020.

- Measures to protect class members against conflicts of interest.

Consultation questions pertaining to a guaranteed statutory minimum return of the gross proceeds of a class action (including settlements)

The present consultation relates to proposals to give effect to the following Recommendation 20 from the PJC Inquiry:

> **Recommendation 20**
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> **The committee recommends the Australian Government consult on:**
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> - **the best way to guarantee a statutory minimum return of the gross proceeds of a class action (including settlements);**
> - **whether a minimum gross return of 70 per cent to class members, as endorsed by some class action law firms and litigation funders, is the most appropriate floor; and**
> - **whether a graduated approach taking into consideration the risk, complexity, length and likely proceeds of the case is appropriate to ensure even higher returns are guaranteed for class members in more straightforward cases.**

The issues which Recommendation 20 seeks to address surround the problem of class members receiving less than their fair share of litigation proceeds in funded proceedings. Those issues were addressed at length in Ai Group's submission to the PJC Inquiry.

Any return to a litigation funder at the finalisation of proceedings, whether that be based on a settlement sum or an amount awarded by a Court, should be proportionate to the cost and risk undertaken, and should avoid the potential for profits which have been described by various judgments as 'stratospheric', 'arguably excessive' and 'not fair and reasonable'.[3]

The establishment of a statutory minimum return would address an important issue recommended by the PJC Inquiry.

A minimum 70% gross return to class members and a maximum 30% return to litigation funders is appropriate.

[3] *Tredrea v KPMG Financial Advisory Services (Australia) Pty Ltd* (No 3) [2019] NSWSC 871, [89], [94]; *Endeavour River Pty Ltd v MG Responsible Entity Limited* [2019] FCA 1719.

Mechanism to implement the minimum return to class members

An appropriate mechanism to implement this minimum return to class members would be to amend the *Corporations Act 2001* (Cth) to make it a condition of holding an Australian Financial Services Licence that a litigation funder not enter into agreements that would result in the funder receiving more than 30% of the amount awarded by a Court, or settled for, including all amounts paid or payable to the funder.

Alternatively, such a condition could be imposed on litigation funders holding an Australian Financial Services Licence through the regulation making power in section 914A(8) of the *Corporations Act 2001* (Cth) which provides:

> The licence is subject to such other conditions as are prescribed by regulations made for the purposes of this subsection. However, ASIC cannot vary or revoke those conditions.

Such reforms could be appropriately supplemented by amendments to the *Federal Court of Australia Act 1976* (Cth) which, as outlined in Recommendation 11 of the PJC Inquiry, require the Court to approve a litigation funding agreement in order for it to be enforceable and empower the Federal Court to reject, vary or amend the terms of any litigation funding agreement when the interests of justice require.

The benefits of such reforms would be to ensure that class members and businesses are not burdened by excessive payments to litigation funders, that the costs of litigation in representative proceedings are kept under control, and that perverse incentives to fund proceedings with the promise of excessive returns are reduced.

Consultation questions pertaining to a graduated approach to guaranteed class member returns

The prospect of a 'graduated approach' to the determination of appropriate class member returns arises out of the third dot point in Recommendation 20 of the PJC Inquiry Report which recommended that the Australian Government consult on whether a graduated approach taking into consideration the risk, complexity, length and likely proceeds of the case is appropriate to ensure even higher returns are guaranteed for class members in more straightforward cases.

We propose that this proposal be implemented by prescribing statutory criteria that a Court would need to take into account in deciding whether the minimum 70% gross return to class members is appropriate in a particular case or whether, for example, 80% or 90% is appropriate.

Parker J of the New South Wales Supreme Court highlighted the fact that a 30% return to a litigation funder will sometimes not be a fair outcome for class members in *Tredrea v KPMG Financial Advisory Services (Australia) Pty Ltd* (No 3):[4] (emphasis added)

[4] Tredrea v KPMG Financial Advisory Services (Australia) Pty Ltd (No 3) [2019] NSWSC 871, [88] – [90].

> In these circumstances, I have been troubled by the fact that LCM seeks a commission calculated on the gross value of the settlement, not the net value after deduction of expenses. Now that the claim has succeeded, virtually all of the costs will be passed back to the Settlement Group Members. LCM seems to be trying to have things both ways.
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> If LCM's application succeeds the only costs it will ultimately bear will be its management costs and the time value of money laid out in funding the litigation. Expressed as a percentage of these actual costs, LCM's return would be stratospheric, in the tens of thousands of per cent.
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> I imagine that when LCM did its sums when deciding to fund the claim, it calculated its return by reference to its likely net, rather than gross, return. The Settlement Group Members' interest in the outcome is properly measured in the same way. The costs incurred are relatively small compared with the settlement but they still run into millions of dollars and a funder's commission of 30% of the gross would still represent an appreciably higher percentage of the Group Members' net recovery. On the face of it, a commission based on gross recovery is arguably quite one-sided…

The problems caused by the current absence of statutory criteria to guide the Court in determining what return to the litigation funder is reasonable in a particular case were commented upon by Lee J in *Liverpool City Council v McGraw-Hill Financial, Inc (now known as S&P Global Inc)* [2018] FCA 1289:[5] (Emphasis added)

> …if I was to interfere with the funding agreements and the amount paid to the funder, in the absence of identified statutory criteria, I would be left adrift searching for a lodestar. Although this may not be an insuperable difficulty and the Court is often required to make broad evaluative assessments (and is required to do so on the ultimate question arising on these applications), it is not a straightforward task. What I regard as a "fair" return may be quite different from somebody else sitting in my position, and without some statutory guideposts and detailed economic evidence, it presents real challenges.

Appropriate guidance to the Court would fill a regulatory gap.

Various factors have been considered by the Federal Court as relevant to the question of the adequacy of a settlement sum. In *Williams v FAI Home Security Pty Ltd* (No 4) [2000] FCA 1925, Goldberg J considered a 'nine-factor test' to be helpful in guiding a proposed settlement. The factors considered relevant were:

> (1) the complexity and duration of the litigation; (2) the reaction of the class to the settlement; (3) the stage of the proceedings; (4) the risks of establishing liability; (5) the risks of establishing damages; (6) the risks of maintaining a class action; (7) the ability of the defendants to withstand a greater judgment; (8) the range of reasonableness of the settlement in light of the best recovery; and (9) the range of reasonableness of the settlement in light of all the attendant risks of litigation.

The nine-factor test has now been reflected in *Class Actions Practice Note (GPN-CA)* at paragraph 15.5.

[5] *Liverpool City Council v McGraw-Hill Financial, Inc (now known as S&P Global Inc)* [2018] FCA 1289, [57].

A modified version of some of the above factors would be appropriate for statutory criteria to guide the Court in determining whether the minimum 70% gross return to class members is appropriate in a particular case (or whether, for example, 80% or 90% is appropriate). Relevant factors would include:

- The complexity of the litigation;
- The duration of the litigation;
- The risks to which the litigation funder was exposed;
- The risks to which class members were exposed;
- The size of the amount awarded by the Court or of the settlement; and
- The financial and other resources that the litigation funder has devoted to the litigation.

Complimentary reforms of benefit to class members

The implementation of a minimum return to class members should be complimented with other reforms to increase protections for class members.

An 'opt-in' class action system

The implementation of an 'opt-in' or closed class action system is an important reform to ensure that class members are not committed to financial obligations they have not seen or considered. The process of 'book-building' whereby the plaintiff law firm actively identifies, contacts and signs-up class members avoids class members' rights with respect to an action being determined without their involvement.

Open class actions are principally of benefit to plaintiff law firms and litigation funders. They have the effect of dramatically increasing the size of a class without those entities going to the time and expense of contacting prospective members and gauging their interest in the claim. This comes at the expense of class members who may not wish to be party to an action or intend to pursue other legal avenues with respect to a claim. The benefits to litigation funders also come at the expense of defendant businesses, in terms of their insurance costs,[6] ability to obtain finance, and share prices, with consequent risks for business viability as, in the absence of a closed class, plaintiff law firms will typically exaggerate the quantum of their claim.

[6] According to a submission made by Marsh to the PJC Inquiry on 11 June 2020, insurance costs for businesses, driven by the large increase in the number of class actions in Australia, have risen by up to 600 per cent.

An 'opt-in' or closed class action regime requires plaintiff law firms to take the time and effort to discuss the claim with relevant class members. Such an approach assists in protecting the rights of class members by ensuring they are not merely passive participants in proceedings and are able to have a greater say in whether an action is brought, the type of action pursued and, in the event of a settled outcome, the quantum and nature of the settlement.

Protection for class members against conflicts of interest

The regulatory response to the concerns addressed by Recommendation 20 of the PJC Inquiry Report should be complimented by appropriate reforms targeted at dealing with conflicts of interest which can arise in representative proceedings. The financial interest held by litigation funders in proceedings can generate a perverse incentive to maximise a financial return at the expense of the financial interests of class members and the pursuit of justice. In our submission to the initial PJC Inquiry, Ai Group proposed a list of reforms which are aimed at addressing such conflicts.

Class members' interests may still be infringed upon when litigation funders make strategic decisions during the course of the litigation. Funders have a significant self-interest in securing payment. Contractual obligations may directly or indirectly give a significant degree of control over an action to the litigation funder. For example, a litigation funder will commonly have an interest in increasing the size of the class, defining it broadly to encompass as large a number of members as possible. This has the potential to result in various sub-groups with widely divergent interests in litigation failing to be represented in a manner which serves their specific circumstances. Litigation funders may also have an interest in pursuing a significant settlement sum at the expense of seeking a resolution by way of a court order.

The potential for conflicts to arise between class members and litigation funders has been recognised by the Courts. For example, in *CJMcG Pty Ltd as Trustee for the CJMcG Superannuation Fund v Boral Limited* (No 2) [2021] FCA 350, Lee J outlined broad concerns relating to such conflicts as follows:[7]

> Indeed, given the nature of the model by which funded securities class actions have developed, there are a range of actual and potential conflicts that may arise. Although there may be conflicts that arise for solicitors, it would be naïve to think that these conflicts are not also present when it comes to funders. As I said in *GetSwift First Instance* (at 116–7 [32]–[33]):
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> > To this list I would add a further and potentially worrisome reason for cases not proceeding to judgment following an initial trial. By reason of the very nature of the commercial model I have described, a desire exists on behalf of the funders to not only obtain a return, but to obtain that return with celerity. To those acting for applicants, there is a need to be alive to the possibility arising of a conflict between the commercial imperatives and demands of the funder, and the interests of the applicants and group members in maximising the recovery of their claims. To suggest simplistically that there is always an alignment

[7] *CJMcG Pty Ltd as Trustee for the CJMcG Superannuation Fund v Boral Limited (No 2)* [2021] FCA 350, [72].

> between the funder and group members (because each have an interest in maximising relevant claims) is to fail to appreciate the difference between a commercial enterprise seeking consistent and predictable returns (and management of risk spanning a number of projects), with the position of a group member involved in one action who has a relatively small amount at stake which the group member may be willing to wager on the possibility of a greater return. ...
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> No doubt this issue could prove a fertile ground for a sophisticated economic and behavioural analysis, but it suffices to note that those acting for applicants have an important role in the administration of justice in ensuring that the interests of group members are not swamped by the interests of funders in obtaining predictable and early returns. This important role is buttressed by the protective and supervisory role that this Court has in approving settlements of such litigation. I stress that, to the extent relevant, the history of settlement approvals suggests that there has been no difficulty and there is no reason whatsoever to doubt the conscientiousness of those commonly acting for applicants, but it might be thought at the very least surprising that this type of litigation never, ever runs to a conclusion.

Similarly, in *Wigmans v AMP Limited* [2021] HCA 7, Gageler, Gordon and Edelman JJ of the High Court acknowledged that a court must be mindful of the existence of conflicts of interest between class members and litigation funders and bring them to account in assessing what is in the best interests of group members.[8]

Such conflicts between class members and litigation funders can easily relate to the divergent interests of plaintiff law firms which share the funder's interest in legal proceedings or may have a financial interest in the funder. The regulatory response to protect class members from litigation funders should take into account the conflicting interests of plaintiff law firms.

The following complimentary reforms would constitute an appropriate and measured response to handling relevant conflicts between litigation funders, plaintiff law firms and class members and augment the reforms envisaged by Recommendation 20 of the PJC Inquiry Report:

- Implement a statutory duty on litigation funders to act in the best interest of plaintiffs. The requirements upon trustees of superannuation funds to make decisions in the best interests of Fund members should be considered in this regard.

- Requiring that law firms be prohibited from holding any financial or commercial interest in a litigation funder involved in litigation that the law firm is involved in.

[8] *Wigmans v AMP Limited* [2021] HCA 7, [117].

Conclusion

The reforms proposed in this submission would markedly improve fairness and justice for class members, whilst preserving sufficient incentives for litigation funders to fund appropriate class actions.

These reforms should apply to all new class actions and those that have already been filed.

A consistent, national approach should be encouraged by the Federal Government to extend the benefits of these amendments to State Courts.

ABOUT THE AUSTRALIAN INDUSTRY GROUP

The Australian Industry Group (Ai Group®) is a peak employer organisation representing traditional, innovative and emerging industry sectors. We are a truly national organisation which has been supporting businesses across Australia for nearly 150 years.

Ai Group is genuinely representative of Australian industry. Together with partner organisations we represent the interests of more than 60,000 businesses employing more than 1 million staff. Our members are small and large businesses in sectors including manufacturing, construction, engineering, transport & logistics, labour hire, mining services, retail, food, the defence industry, civil airlines and ICT.

Our vision is for thriving industries and a prosperous community. We offer our membership strong advocacy and an effective voice at all levels of government underpinned by our respected position of policy leadership and political non-partisanship.

With more than 250 staff and networks of relationships that extend beyond borders (domestic and international) we have the resources and the expertise to meet the changing needs of our membership. We provide the practical information, advice and assistance businesses need. Our deep experience of industrial relations and workplace law positions Ai Group as Australia's leading industrial advocate.

We listen and we support our members in facing their challenges by remaining at the cutting edge of policy debate and legislative change. We provide solution-driven advice to address business opportunities and risks.

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