PARLIAMENTARY JOINT COMMITTEE ON CORPORATIONS AND FINANCIAL SERVICES INQUIRY INTO THE CORPORATIONS AMENDMENT (IMPROVING OUTCOMES FOR LITIGATION FUNDING PARTICIPANTS) BILL 2021

SUBMISSION OF LITIGATION CAPITAL MANAGEMENT LIMITED
5 November 2021

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SUMMARY OF LCM SUBMISSION

A. Proscribed minimum returns for class members are a wolf in sheep's clothing. On their face, they appear to offer group members added protection, while in reality they take away those group members' very ability to seek redress for wrongs that they have suffered. (See **Part B, page 3**)

B. A disciplined, evidence-based analysis of the proposed changes would show that they will undoubtedly prevent hundreds of thousands of Australians from pursuing their meritorious claims.

C. The reality of class actions is that they are expensive to progress – they often cost between $5million and $10million to finalise. Sometimes less, often more. Because of this, a proscribed 70% return to class members will mean that most class actions that seek less than $100million in damages will be uncommercial to fund and will not obtain funding from reputable funders. The Bill will thereby shut the door on funding for the bulk of meritorious class action claims that have historically progressed with the benefit of funding assistance.

D. Limiting the claimants' costs is not the answer. It is not 'fair'. If claimants try to restrict their costs in order to squeeze their claim into the funding model imposed by the Bill, they will be at a colossal tactical disadvantage when facing a well-heeled defendant with unlimited resources and large, highly skilled legal teams. The Bill would create a situation where the claimants are simply 'out-gunned'.

E. LCM has long advocated for relevant and effective regulation of the litigation funding industry. However, the managed investment scheme regime is not relevant and it is not effective for the funding of class actions. At best, the regime produces no discernible benefit to group members and, at worst, it is impossible or impractical to comply with. (See **Part C, page 5**).

F. The Bill encourages 'closed' class actions, to the detriment of claimants, defendants and Court processes. (See **Part D, page 6**).

G. The Bill otherwise unreasonably fetters judicial discretion, introduces impossibly vague civil penalty provisions and incorporates provisions that are open to Constitutional and other challenges. (See **Part E, page 6**).

H. The Bill has not had the benefit of sufficient consideration and meaningful consultation. It needs finessing in some parts and it needs fundamental rework in others.

PART A: LITIGATION CAPITAL MANAGEMENT LTD

1. Litigation Capital Management Limited and its subsidiaries ("LCM") is a provider of litigation finance products and from that perspective makes the following submission in response to the Parliamentary Joint Committee ("PJC") on Corporations and Financial Services Inquiry ("Inquiry") into the *Corporations Amendment (Improving Outcomes For Litigation Funding Participants) Bill 2021* ("Bill").

2. Founded in 1998, LCM was one of the first professional litigation funders in Australia, and it is one of the longest-standing litigation funders globally. LCM holds an Australian Financial Services Licence and is a publicly listed Australian company, headquartered in Sydney and with offices in Melbourne, Brisbane, Singapore and London.

3. Since its inception, LCM has continued to assist claimants to pursue meritorious claims and recover funds from the legal avenues and actions available to them. LCM funds commercial, insolvency and arbitral proceedings, as well as representative actions.

PART B: MINIMUM RETURNS TO CLASS MEMBERS

4. LCM submits that no cogent, evidence-based consideration has been given to the question of whether a rebuttable presumption of minimum returns to class members is, on the whole, going to protect or benefit class action group members, or maintain access to justice.

5. It is LCM's submission that if a disciplined analysis were undertaken, it would make clear that such a change, if effected, will undoubtedly prevent hundreds of thousands of Australians from seeking redress for wrongs that have affected them.

6. LCM does not doubt that if a proscribed minimum return to group members is introduced, in some of the class actions that nevertheless receive funding, the returns to group members may be higher than those they would have otherwise achieved. However, LCM stresses that the number of such class actions, i.e. class actions that nevertheless receive funding, will dramatically decrease.

7. Importantly, if meritorious actions are not funded, it does not mean that they will progress as unfunded claims. LCM submits that a very small percentage of such claims would be commenced and progress to a resolution unfunded. That small percentage would also be likely to be progressed by plaintiff firms on a contingency basis in the Supreme Court of Victoria, where the commissions such firms can charge are not capped.

8. As noted in the PJC December 2020 Report "Litigation funding and the regulation of the class action industry" ("PJC Report") (at 5.5):

> *"…the committee recognises that, in many instances, a class action could not proceed in Australia without a litigation funder."*

How does the Bill restrict funding for class actions?

9. Funders are selective about the claims that they fund[1], and a funder's appetite for supporting class actions is not inelastic.

10. Funders do not have to fund class actions, and if class action regulation is changed in a way that shifts the balance between risk and return beyond acceptable limits, funders simply will not continue to fund these claims and will instead continue to increase their investments in other claim types such as insolvency, arbitration and commercial litigation (for which there is a developed litigation funding market in both Australia and globally).

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[1] By way of example, LCM provides funding to only between 3% and 7% of the applications it receives

11. The cost of doing pursuing a class action claim is usually more than $5million. It is often more than $10million. Class action funding is also a highly specialised, risky and almost entirely illiquid investment. It is in this context that funders make decisions as to whether to agree to fund a proceeding.

12. Relevantly to the Bill, when considering a claim for funding, one of the key matters that funders carefully review is the 'proportionality' between the budgeted investment sum and the likely recovery. Reputable funders do not accept matters for funding if it is not clear that the size of the claim is sufficient to allow for a) the full legal spend anticipated, b) the funding commission, c) the bulk of the recovery being paid to the claimants and d) a "buffer" to allow for settlement discounts, increases in costs and potential reductions in claim value as the claim develops.

13. Because of this, the use of a predetermined minimum for class member returns has a direct impact on the size of the claim that the funder is able to accept as sufficiently 'proportionate' to meet its criteria for funding.

14. A worked demonstration of a funder's 'proportionality' analysis is enclosed at Annexure A to this Submission. Applying that analysis to realistic class action budget figures arrives at the following claim size parameters:

Budget	**Minimum required claim size**
$5,000,000	$125,000,000
$10,000,000	$250,000,000
$15,000,000	$375,000,000

15. The above demonstrates that <u>if 70% minimum returns were to be introduced, class action schemes with claims that are smaller than the minimums noted above simply will not be able to obtain funding from reputable funders</u>.

16. Empirical evidence[2] further shows that this would affect the bulk of class actions that have historically progressed with the benefit of funding assistance.

<u>Lowering claimants' costs – not a solution</u>

17. Although the above comments are dependent on the premise that class actions are very expensive to progress, LCM submits that any responding suggestion that lawyers and funders should limit those costs would overlook the nature of a class action proceeding.

18. LCM submits that in Australia's adversarial class action system, restricting the claimants' costs is not an option. It is not 'fair'.

19. If claimants try to restrict their costs in order to squeeze their claim into the funding model imposed by the Bill, they would be at a colossal tactical disadvantage when facing a well-heeled defendant with unlimited resources and large, highly skilled legal teams. The Bill would ensure that the claimants are simply 'out-gunned'.

[2] See, for example, Professor Vince Morabito's data in "*Post-Money Max Settlements in Funded Part IVA Proceedings*" (December 2020); PWC Report "*Models for the Regulation of Returns to Litigation Funders*" (March 2021)

"It's only a rebuttable presumption" – not an answer

20. LCM acknowledges that the Bill does not fix a guaranteed minimum return to class members, but rather introduces a rebuttable presumption that the scheme's distribution method is not fair and reasonable if more than 30% of the claim proceeds for the scheme are to be paid to parties other than its members.

21. LCM nevertheless highlights that when undertaking a commerciality analysis at the outset of a matter, reputable funders will not rely on the hope that the presumption will be rebutted. It is an additional risk in the claim and, unfortunately for claimants, it is a risk that, by its very nature, funders cannot price for.

22. Consequently, LCM submits that the framing of the guaranteed minimum as a rebuttable presumption does not alleviate the chilling effect that this aspect of the Bill will have on the availability of funding for smaller and mid-sized class action claims.

The reality of litigation

23. Finally, LCM submits that the Bill must also be considered in its broadest context.

24. It is trite to say that class actions are pieces of litigation, but this simple point is consistently overlooked. Class actions are large-scale complex litigation, and that litigation is adversarial, it is risky and it is expensive. LCM submits that it cannot be ignored that by participating in a class action, this is the process that class members are embarking upon. They are not simply applying for compensation through a scheme whereby the payment of such compensation is a certainty, far from it.

25. Litigation is inherently unpredictable – an action is commenced with imperfect information, progressed through an adversarial process and adjudicated by a member of the judiciary. The risk of a complete loss or an unsatisfactory outcome is an unfortunate aspect of litigation reality, and the cost of advancing a claim, particularly against a combative defendant, can have a very significant impact on an action's ultimate proceeds. This is true of both funded and unfunded proceedings, both commercial claims and class actions.

26. Never in the history of litigation have lawyers, barristers, experts, legislators or Courts guaranteed to any plaintiff that they will receive a particular minimum return from pursuing their claim. LCM submits that there is no clear basis for proposing to treat plaintiffs differently now, solely because they are in a funded class.

PART C: DEFINITION OF MANAGED INVESTMENT SCHEME

27. LCM has long supported fit-for-purpose, effective and meaningful regulation of the litigation funding industry.

28. Unfortunately, LCM submits that the Bill's deeming of class action litigation funding schemes to be managed investment schemes ("MIS") is a missed opportunity to offer the industry and, importantly, the claimants, a framework that actually assists them.

29. LCM submits that there are innumerable ways in which the MIS regime could be improved upon if it were to offer clear and relevant protections for claimants. LCM further submits that there are many considerations that tell strongly against the inclusion of a funded class action within the definition of an MIS.

30. LCM has previously made detailed submissions on the unsuitability of the MIS regime (see here). The relevant extract from these submissions is set out at Annexure B.

31. In summary, LCM submits that the overall picture is that there are a significant number of important aspects of the substantive regime governing the MIS which at best produce no discernible benefit to group members and at worst are impossible or impractical to comply with.

PART D: CURTAILING 'OPEN' CLASS ACTIONS AND CONVERTING TO 'OPT-IN' MODEL

32. From its inception, the class action regime in Australia has operated on an 'opt-out' basis, whereby all potential claimants who fall within the definition of the class become members of the class on the filing of the claim, whether they are aware of it or not.

33. In enacting the class action regime, the Government determined that an open class system with an 'opt-out' procedure was preferable on the grounds of equity, as well as efficiency. The then Attorney-General said:

> *"It ensures that people, particularly those who are poor or less educated, can obtain redress where they may be unable to take the positive step of having themselves included in the proceeding*"[3]

34. Contrary to the above, it is a key intention of the Bill that claimants must consent to become members to a class action litigation funding scheme in writing. The requirement for this positive action shifts class actions from an 'opt-out', to an 'opt-in' model.

35. This change reverses the approach to class member participation that has been a cornerstone of Australian class actions since its inception, which will have far-reaching consequences and will negatively impact fair and equitable outcomes for plaintiffs.

36. A natural consequence of this approach is that funders will proceed to book-build and will seek to commence all claims on a 'closed' basis. This move will increase the risk of multiple class actions being run in one Court or across different Courts against the same defendant. This may have the effect of increasing defendant costs, as they may need to face multiple closed claims/different schemes instead of one 'open' claim. Defendants will also never have certainty nor finality in resolving any one 'closed' class action, as that resolution would not prevent another 'closed' claim being commenced in relation to the same set of facts.

PART E: EXAMPLES OF BILL'S FURTHER UNWORKABLE ASPECTS

Fettering of judicial discretion

37. LCM submits that the present wording of the Bill unacceptably fetters the Courts' discretion[4] and interferes with the Courts' overarching purpose of facilitating the just

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[3] Commonwealth, Parliamentary Debates, House of Representatives, 14 November 1991, 3174-3175 (Michael Duffy, Attorney-General)

[4] By analogy, in *Nicholas v The Queen* (1998) 193 CLR 173 at 188 Brennan CJ found that "*A law that purports to direct the manner in which the judicial power should be exercised is constitutionally invalid.*"

resolution of disputes according to law as quickly, inexpensively and efficiently as possible[5].

38. In particular, LCM notes that proposed section 601LG(3) states that:

"… in considering whether the scheme's claim proceeds distribution method, or any variation of that method, ***is fair and reasonable*** *when considering the interests of the scheme's members as a whole, the Court* ***must only*** *have regard to the following factors…."*(Our emphasis)

39. There is well-developed jurisprudence in relation to the Court's exercise of its supervisory power in the context of class action settlement approvals and distributions. The Courts have been active in considering and developing criteria for approving, and ultimately modifying and setting, funding commissions in class actions. They have repeatedly considered and confirmed that commissions ought to be "fair and reasonable".

40. Further, the list of factors specified within the section is overly restrictive and does not take into account all of the aspects of a class action funding process that may be relevant to a consideration of "fairness and reasonableness".

41. In the circumstances, LCM submits that it is entirely inappropriate for the Bill to limit the factors that the Court is able to take into account. The concept of fairness cannot be decided with a hand over one eye. The Court must have all relevant circumstances before it.

42. Consequently LCM submits that section 601LG(3) must be amended to replace "must only" with "may" or, at a minimum, "must".

43. Further, proposed section 601LG(4) states that:

"Regulations made for the purposes of this subsection may provide that this section applies as if subsection (3) were omitted, modified or varied as specified in the regulations."

44. LCM submits that it is again entirely inappropriate for this Bill to open the door for Government to subsequently interfere with judicial discretion by way of Regulation.

45. The Bill's Explanatory Memorandum at [1.75] – [1.77] states that this provision is necessary so that:

"… the fairness and reasonableness test remains a relevant and appropriate protection for class members into the future. There is a potential for new factors to be relevant to the Court's consideration of the test as the conduct of litigation funding schemes, the types of matters that are funded, and the entities and claimants involved in such schemes evolve to suit commercial circumstances. The industry evolves rapidly in response to new regulations and standards for litigation funding.

[5] For example, sections 37M and 37N of the *Federal Court of Australia Act* 1976 (Cth) and Part 7 of the Central Practice Note (CPN-1); Section 7 of the *Civil Procedure Act* 2010 (Vic)

It is necessary for these changes to be made in regulations so that Government can quickly act to recognise new practices and to protect the interests of the members of class action litigation funding schemes.

In order to ensure that the test is always relevant and provides effective protection for members of the scheme, the Government should be able to respond to new developments by modifying the test with respect to factors the Court must consider when conducting the test."

46. LCM submits that the above explanation overlooks the Court's well-established supervisory role in class action proceedings and submits that Courts are, in fact, the best placed to "quickly act to recognise new practices and to protect the interests of the members of class action litigation funding schemes". The proposed section 601LG(4) should not be enacted.

Prospect of Constitutional and other challenges

47. LCM notes that it is arguable that some or all of the Bill may be open to Constitutional and other challenges on a number of grounds. This is not addressed in the Bill's Explanatory Materials, and does not appear to have received sufficient consideration or have been the subject of appropriate consultation. The potential for Constitutional challenge will create further uncertainty, with such uncertainty likely to have an additional dampening effect on the willingness of funders to fund class actions.

Vague civil penalty provisions

48. The Bill proposes to introduce civil penalty provisions, under the title "Anti-avoidance".

49. Although LCM does not take issue with the sentiment behind the provisions, LCM submits that the wording of the proposed section is entirely unworkable, particularly when one takes into account its serious consequences.

50. In particular, LCM highlights the following aspects of proposed section 9AAA(2):

"If:

(a) one or more persons ***enter into, begin to carry out or carry out a plan****; and*
(b) ***it would be concluded*** *that the person, or any of the persons, who entered into, began to carry out or carried out the plan or any part of the plan* ***did so for a purpose*** *(whether or not the dominant purpose but not including an incidental purpose) of avoiding the of..."*

51. LCM submits that the terms, and particularly the emphasised terms, used in the above provision are impossibly broad and vague. It is entirely unclear what circumstances would be caught by this provision. The Bill is specific about the circumstances it is seeking to regulate. If there are other circumstances which remain unregulated by the Bill (for example, a solicitor seeking a group costs order in a class action in the Victorian Supreme Court) and are otherwise lawful, then engaging in these alternatives should not be at risk of breaching of the Act. A civil penalty provision should only relate to expressly prohibited conduct, as to include a provision which is in such vague terms but has a civil penalty outcome is potentially unconstitutional.

CONCLUSION

52. LCM submits that any changes to Australia's litigation funding industry and class actions regime must be carefully considered and structured, with the benefit of genuine and broad stakeholder consultation. It is LCM's submission that meaningful consideration and consultation has not taken place in the very short time that the Bill has been developed and made available for comment. LCM submits that the Bill is, therefore, premature and underdone. It needs finessing in some parts. And it needs fundamental rework in others.

ANNEXURE A
'Proportionality' analysis (see paragraph 14 of the Submission)

The following is a reverse-engineered demonstration of a 'proportionality' analysis in the context of a guaranteed 70% return to class members:

1. By way of example, the costs of a class action are estimated to be $1million;

2. Due to the risk profile of a class action, common pricing structures would see funders aiming for a return on invested capital ("ROIC") of 3x. The funder would therefore seek to allow for a $3million commission in its calculations;

3. In order for class members to recover the anticipated minimum of 70% in this claim, the aggregate of the above costs and commission would need to represent no more than 30% of the claim's recovery. The total minimum recovery would therefore need to be more than $13.3million:

   [($1m costs + $3m commission) / 30% x 100%] = $13.3m]

4. However, claims do not usually resolve for 100% of their formulated claim value. Therefore, the funder may allow for a settlement/litigation risk discount. Depending on the claim, a prudent and conservative funder approaching the claim in its infancy could estimate this to be up to 50%. Therefore, in order to achieve a recovery of $13.3million, the claim size would need to be over $25million:

   [$13.3m / 50% x 100% = $26.6m]

5. The above analysis shows that with a budget of $1million and a guaranteed minimum return to class members of 70%, claims with a quantum below $25million would not meet reputable funders' 'proportionality' criteria and would not be funded.

ANNEXURE B
EXTRACT FROM LCM SUBMISSION TO CONSULTATION ON EXPOSURE DRAFT LEGISLATION TREASURY LAWS AMENDMENT (MEASURES FOR CONSULTATION) BILL 2021: LITIGATION FUNDERS (PART D)

1. The overall legislative purpose of the regulation of MIS is to regulate closely the operation of a scheme whereby members may otherwise be at risk of losing the capital which they have invested and surrendered day to day control of, including to regulate the ability of members to achieve a ready exit from the scheme. That purpose plainly does not cohere with inclusion of a funded class action in the definition of an MIS, in circumstances where:

    1.1. There already exists a statutory regime regulating the conduct of a class action in the best interests of group members, including through the supervisory role of the Court;[6]

    1.2. Group members in a class action do not place capital at risk in the same way as usually occurs in an MIS; and

    1.3. The statutory regime already provides for the circumstances in which a group member may withdraw from a class action through the exercise of opt out rights.

2. These considerations tell strongly against the inclusion of a funded class action within the definition of an MIS.

3. The difficulties in applying Chapter 5C to litigation funding schemes are not merely around the edges. They go to the heart of the Chapter 5C regime. In particular, it is unclear:

    3.1. Who is to be the RE of the scheme or who is required to "operate" the scheme under section 601FB(1) of the Act, this being a central objective of the changes made by the *Managed Investments Act*. The funder is not a good candidate, as the funder typically (and in the present case) does not have day to day control over the litigation, that being reposed in the representative applicant's ability to give instructions to the lawyers. The lawyers are not a good candidate either and in any event are prohibited from operating an MIS.[7] Even ASIC appears to be uncertain as to who the RE of a litigation funding scheme should be and whether or not litigation funders could be the RE consistent with the obligations of an RE under the Act[8];

    3.2. If it is the litigation funder who is to be the RE of the scheme, how the litigation funder could comply with the central obligation in section 601FC(1)(c) of the Act for the RE of an MIS to act in the best interests of the members of the MIS and, if there is a conflict between its own interests and the members' interests, to give priority to the members' interests; that is, to act as a fiduciary. If the funder is taken to be the RE, this requirement would appear, for example, to restrain the funder from exercising its contractual rights in its own interests to withdraw from funding proceedings in respect of which it had become clear that the proceedings lacked sufficient prospects of recovery, or were otherwise uneconomic. To impose a fiduciary duty on a funder as the RE of a litigation

[6] *Wigmans v AMP Ltd* (2021) 388 ALR 272; [2021] HCA 7 at [82] (Gageler, Gordon and Edelman JJ).
[7] See eg *Legal Profession Uniform Law* (NSW) s 258(1).
[8] See ASIC's submission to the Parliamentary Joint Commission inquiry into litigation funding and the regulation of the class action industry dated June 2020.

funding scheme would be particularly inapposite given that in a litigation funding scheme, it is only the funder who has placed its capital on risk, and where the funder will have fiduciary duties to its shareholders and investors which might conflict with those of members. It is also inconsistent with Court practice in relation to class actions, which acknowledges that funder and member interests may diverge, for example in settlement approval proceedings during which payment of the funder's commission from a recovery is approved;

3.3. How scheme property, being at least (*ex hypothesi*) the contractual promises of members to pay certain sums to the funder from any resolution sum,[9] is to be held on trust for members of the scheme by the RE as required by section 601FC(2) of the Act;

3.4. Further, it seems on the Brookfield FC approach, that the "scheme property" necessarily includes all promises made by the group members and all promises from the funder; and further that the "members" of the Scheme who benefit from the use of the scheme property include not just all group members but also the funder. There would be a total disjunct in applying these notions of scheme property and trust to a funded litigation arrangement.

4. Applying the MIS definition to class actions will also cause further inconvenience and mischief which includes:

4.1. Section 601FC(1)(d) of the Act requires the RE of an MIS to treat members who hold interests of the same class equally. There is a concern, recorded in a recent ASIC Consultation Paper, that this might require a resolution sum to be distributed equally in dollar terms among group members, notwithstanding that group members' claim sizes may differ. It is also unclear how this might affect the negotiation of settlement where one subset of the group may have stronger claims than another;

4.2. ASIC requirements in relation to solvency, net tangible assets and the like are being imposed in respect of REs of litigation funding schemes. This has led funders to enter into a custodian arrangements with professional trustees to hold "scheme property" in respect of any future registered MIS. ASIC has required this as a condition of an Australian Financial Services Licence ("AFSL") permitting the operation of a litigation funding scheme. It is not clear what the custodian would actually do in practical terms as custodian to "hold" scheme property or indeed how extensive that scheme property is;

4.3. The MIS regime gives group members a statutory right to call a members' meeting and receive statements of resolutions to be moved on. The requirement that any special or extraordinary resolution put to vote at such a meeting be decided by a poll, with member allocation of votes determined by the value of their interest in the MIS also cannot practically be complied with in light of the nature of the scheme property in a class action litigation funding scheme; and

4.4. Issuing interests in an MIS triggers requirements under the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* (Cth), requiring the RE to take steps which serve no practical purpose in the context of a litigation funding scheme.

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[9] "Scheme property" is defined in s 9 of the Act relevantly to include "*contributions of money or money's worth to the scheme*".

5. Further, aspects of the MIS regime in the Act overlap with, and create a real potential for conflict with, the Court's supervisory jurisdiction under Part IVA of the FCA Act. In particular:

5.1. Sections 601KA to 601KE prevent members of an MIS from withdrawing from the MIS other than in accordance with those provisions (which vary depending upon the liquidity of the scheme). By contrast, group members have an unqualified right to opt out of a class action prior to the date fixed for opt out, under section 33J of the FCA Act. ASIC has presently provided relief in relation to this;

5.2. The requirement under section 1012B of the Act for a Product Disclosure Statement ("PDS") to be issued to prospective members of a scheme means that scheme members will receive the kind of detailed information about contemplated class action proceedings that would ordinarily be included in group member notices, without that information being disseminated under Court supervision;

5.3. A PDS is required to contain information that would, if disseminated publicly, confer a tactical advantage on the respondent to a potential class action, including as to budgeting. By contrast, rules of Court typically allow such information to be redacted from the copy of the funding agreement served upon a class action respondent. ASIC has presently provided relief in relation to this requirement.