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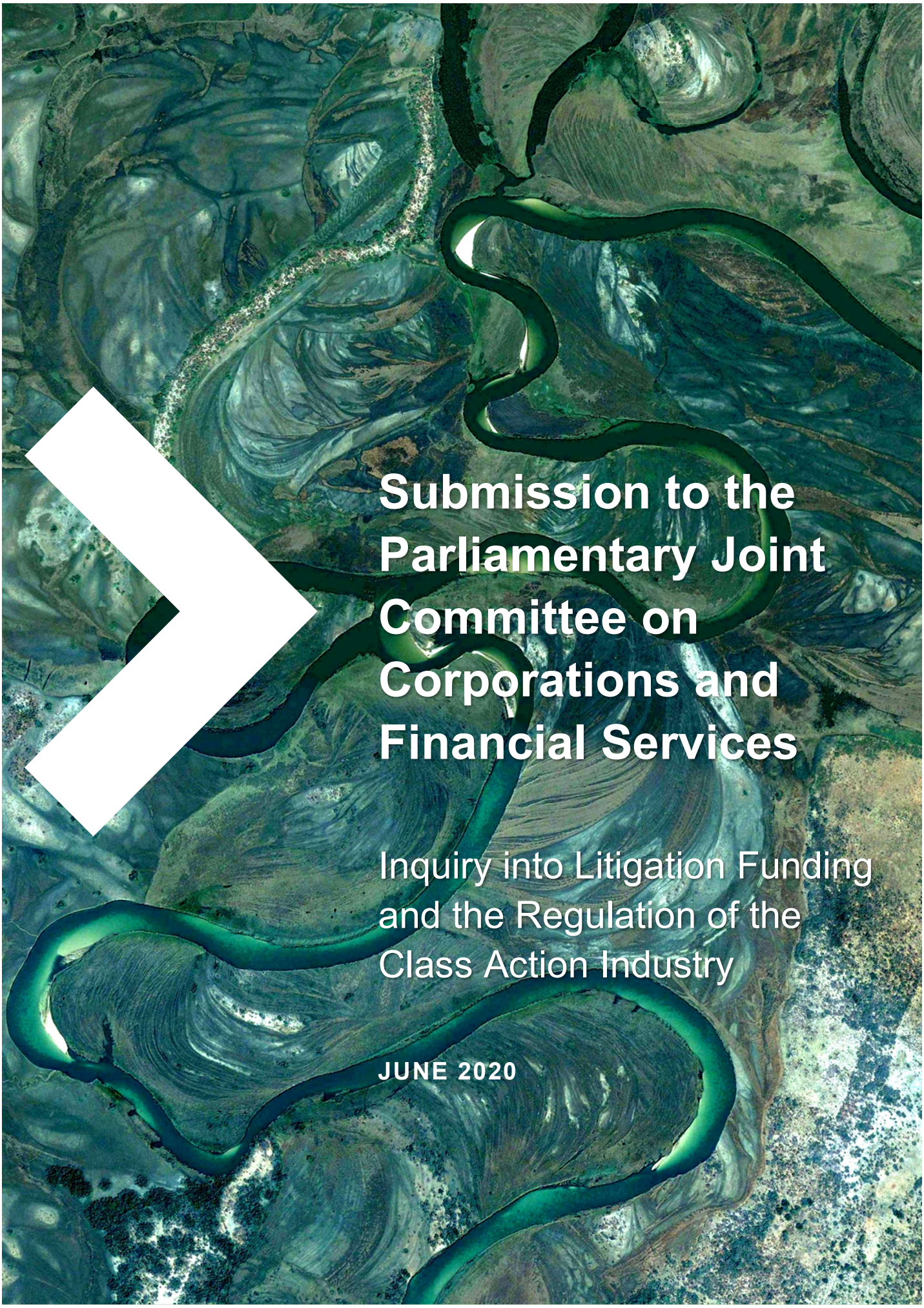

Submission to the Parliamentary Joint Committee on Corporations and Financial Services

Inquiry into Litigation Funding and the Regulation of the Class Action Industry

JUNE 2020

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Introduction

1 We appreciate this opportunity to make a submission to the Parliamentary Joint Committee on Corporations and Financial Services in respect of its inquiry into litigation funding and the regulation of the class action industry.

2 The Allens disputes team has a long history of acting for defendants in class actions. We have been involved in class actions in the federal and state courts across a broad range of contexts including shareholder, product liability, consumer protection, financial products, cartel, environmental damage, natural disaster, human health and employee rights. We have also been involved in the ground-breaking claims that have shaped modern class action practice – including the first major funded class action, the first 'closed class' class action, the first shareholder class action to go to trial, the first cartel class action, the first class action in which 'funding equalisation' was ordered, the first case in which a common fund order was made, and the recent cases in which common fund orders and class closure orders were disallowed. This experience gives us a unique perspective from which to comment on the issues raised by this inquiry.

3 Allens has advocated reform to the class action regime for many years. We have made detailed submissions to the class action inquiries conducted by the Australian Law Reform Commission (***ALRC Inquiry***)[1] and the Victorian Law Reform Commission (***VLRC Inquiry***).[2] For a number of years we have also conducted detailed analyses of class action filings to paint a picture of the changing class action landscape, and have released an annual *Class Action Risk* report setting out key observations and trends.[3]

4 We consider that the objectives of the class action regime require the interests of both plaintiffs and defendants to be given fair and balanced consideration. Of particular concern to us is the increasing entrepreneurialism of plaintiff lawyers and litigation funders, which has resulted in conduct that appears to prioritise the interests of lawyers and/or litigation funders over the interests of group members and has become the defining feature of Australia's class action environment.[4]

5 We therefore welcome the class action reforms announced recently, and think they are an important step forward. However, further reform is required to achieve an appropriate balance in the class action legal landscape.

6 It is important that timely action is taken in light of the current business and class action environment arising from the COVID-19 pandemic.

7 We have responded to the issues raised by the Terms of Reference set out below. While our submission addresses reform to the federal regime, we consider that ideally any reform would be enacted consistently across the federal and state regimes.

(a) **Section 1 – Economic impacts of Australia's current class action industry, including during COVID-19:** The COVID-19 pandemic has highlighted that Australia is viewed as one of the most favourable jurisdictions for shareholders, lawyers and litigation funders to

[1] Allens submission to the ALRC, *Inquiry into Class Action Proceedings and Third Party Litigation Funders* (August 2018) (***Allens ALRC Submission***): https://www.alrc.gov.au/wp-content/uploads/2019/08/52_allens.pdf.

[2] Allens Submission to the VLRC, *Litigation Funding and Group Proceedings* (September 2017) (***Allens VLRC Submission***): https://www.lawreform.vic.gov.au/sites/default/files/Submission%2012_Allens_22-09-17.pdf.

[3] Our most recent report, *Class Action Risk 2020*, was released in March 2020 and is available here: https://www.allens.com.au/globalassets/pdfs/campaigns/class_action_risk_report_2020.pdf

[4] These issues are addressed in the Allens ALRC and VLRC Submissions, as well as our *Class Action Risk 2020* report: https://www.allens.com.au/globalassets/pdfs/campaigns/class_action_risk_report_2020.pdf.

pursue listed companies for alleged contraventions of market disclosure obligations. Aside from the obvious financial costs of this, the risk of shareholder class actions has resulted in an over-concentration on continuous disclosure discussions at the board level, sometimes at the expense of other matters such as pursuing profit making objectives of the company for the benefit of shareholders. We welcome and support recent measures taken by the Australian Government to address the current lack of balance in the class action regime by temporarily easing the continuous disclosure rules under the *Corporations Act 2001* (Cth) (***Corporations Act***). However, the measures are temporary and have some clear limitations. We encourage the Australian Government to implement more comprehensive and permanent reform to prevent the proliferation of opportunistic shareholder class actions in Australia.

(b) **Section 2 – Regulation of litigation funders:** It has been Allens' position for some time that regulation of the litigation funding industry is required. We have become increasingly concerned that the entrepreneurial forces in class actions are developing in a way that has led to increasing instances of conduct that appears to prioritise the interests of lawyers and/or litigation funders over the interests of group members. We therefore welcome the Australian Government's recent announcement of the regulation of funders. However, to ensure the effectiveness of this reform, we consider that further steps are required to tailor the Australian Financial Services Licence (***AFSL***) and managed investment scheme (***MIS***) regimes to the particular circumstances of litigation funding. We also consider that further reforms are required with respect to court supervision of litigation funders and the supervision and regulation of the relationship between lawyers and litigation funders.

(c) **Section 3 – Common fund orders:** We are of the view that common fund orders and similar arrangements should not form any part of Australia's class action regime. We oppose any legislative intervention that would alter the recent decision of the High Court that there is no power to make such orders under the current regime. Common fund orders do not increase access to justice or facilitate fair and equitable outcomes for plaintiffs, and have led to an increase in competing class actions. These fundamental problems with common fund orders apply equally at all stages of a class action, including at settlement, and such orders should not be allowed at any stage.

(d) **Section 4 – Class closure orders:** We consider class closure orders to be an essential aspect of the class action regime. Such orders facilitate settlement and allow finality to be achieved for both the group members and the defendant. We are of the view that the class action regime in the *Federal Court Rules 2011* (Cth) should be amended to include an equivalent provision to s 33ZG of the *Supreme Court Act 1986* (Vic) (***Supreme Court Act***) which expressly permits the making of a class closure order.

(e) **Section 5 – Contingency Fees:** We are opposed to lifting the current ban on contingency fees. We consider that contingency fee arrangements are unlikely to improve access to justice or result in greater returns to group members. In our opinion, lifting the prohibition on contingency fees may lead to less financially viable outcomes for plaintiffs in claims that would otherwise have been run on a 'no win, no fee' basis. Such arrangements also risk conflicts of interest and may give rise to an abuse of process.

Section 1: Economic Impacts of Australia's Current Class Action Industry, Including During COVID-19

1 The following items in the inquiry's Terms of Reference raise issues in relation to the economic impacts of Australia's current class action industry:

(a) what evidence is becoming available with respect to the present and potential future impact of class actions on the Australian economy; and

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

2 The COVID-19 pandemic has brought into sharp focus the current lack of balance in the class action regime in favour of litigation funders and plaintiff firms and the impact entrepreneurialism is having on the Australian economy. That impact is most stark in the area of shareholder class actions.

3 The Australian Government has recognised the need to address this imbalance in the system with the recent announcement on 22 May 2020 of an immediate temporary easing of the continuous disclosure rules under the Corporations Act. Treasurer Josh Frydenberg MP cited the 'threat of opportunistic class actions' as the key reason for the change.[5]

4 Whilst the COVID-19 pandemic may explain the timing of this important change being introduced, the imbalance in the class action regime that these measures seek to address has existed well before and will continue to exist well after the current pandemic.

5 Allens has long supported a review of the continuous disclosure regime and the private rights of action arising from a possible breach.[6] The temporary measures announced are a welcome step in the right direction but have clear limitations. We would support the Australian Government continuing to step in that direction by implementing more wide-ranging and permanent reform in this area.

Australia's current shareholder class action environment

6 In our submission to the ALRC Inquiry, we set out data in relation to Australia's current shareholder class action environment.[7] That data demonstrates that:

(a) there is a clear increase in shareholder class action activity over the last five years; and

(b) more shareholder class actions have been filed than any other type of class action.[8]

7 In 2019 there was somewhat of a softening in shareholder class action filings, with a rise in consumer class actions, including as a result of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry. In 2019, however, shareholder class actions still comprised 23% of all class action filings.[9]

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[5] The Hon Josh Frydenberg MP, 'Media Release: Temporary Changes to Continuous Disclosure Provisions for Companies and Officers', 25 May 2020.

[6] ALRC Submission, 3, 6-18.

[7] Ibid at 7-8.

[8] Allens, *Special Report: Class Action Risk 2016* (19 August 2016), https://www.allens.com.au/general/forms/pdf/ClassActionRisk2016.pdf; Allens, *25 Years of Class Actions: Where are we up to and where are we headed* (25 March 2017), https://www.allens.com.au/pubs/class/papclass27mar17.htm.

[9] Allens, *Class Action Risk 2020* report, (March 2020) at 6, https://www.allens.com.au/globalassets/pdfs/campaigns/class_action_risk_report_2020.pdf.

8 The correlation between the rise in litigation funding in Australia and the increase in the number of competing shareholder class actions being commenced is indicative of the entrepreneurial nature of the industry and raises serious questions about the motivation for bringing these claims. Competing class actions were particularly prevalent in 2017 and 2018. There was some softening in the number of competing claims being filed in 2019, which we consider is at least partly explained by recent uncertainty regarding approaches taken by the courts to managing competing class actions and the availability of common fund orders,[10] which tended to encourage a 'race to the court' and to discourage funders from undertaking any thorough 'book build' process.[11]

9 Today, Australia is considered to be one of the most favourable jurisdictions in the world for aggrieved shareholders – and their lawyers and litigation funders – to pursue listed companies for alleged contraventions of market disclosure obligations. It has become a fact of corporate life that after any significant share price drop, there is likely to be an announcement by at least one law firm (and often multiple firms) that they are investigating the company's conduct and inviting shareholders to register their interest in participating in a class action. Should a class action ultimately be filed, experience suggests that the class and the company are in for years of drawn-out litigation which is usually brought to an end by a settlement.

10 Unsurprisingly in these circumstances, shareholder class actions are having a significant (and draining) effect on listed entities and their insurers. Aside from the obvious costs (a significant proportion of which 'leaks' to lawyers and funders), it is also becoming increasingly apparent that shareholder class action risk is attracting a disproportionate level of attention at board level and changing the approach to continuous disclosure obligations in ways that do not necessarily align with the objectives of the disclosure regime.

11 As we see it, the objectives of both the class action and continuous disclosure regimes are at serious risk of being compromised by the way in which the practices surrounding shareholder class actions have evolved (and continue to evolve). In particular, we are concerned that, without reform of the private rights of action arising from the alleged breach of continuous disclosure obligations, the continuation of current trends will be detrimental to:

(a) shareholders;

(b) the efficacy of the class action regime more generally; and

(c) the efficacy of the continuous disclosure regime, including the objective of having an informed market for publicly traded securities.

12 It is generally accepted that:

(a) the shareholder class action environment has developed in ways that were not foreseen when the class action regime was enacted in 1992; and

(b) those who introduced the continuous disclosure and misleading or deceptive conduct laws did not foresee how those laws would be deployed by the promoters of shareholder class actions.

13 In those circumstances it is perhaps not surprising that, as the ALRC noted, there is growing evidence of 'unintended adverse consequences' caused by the existing framework of the Australian class action regime, coupled with the peculiar characteristics of the Australian statutory provisions concerning continuous disclosure obligations (as compared with some other cognate

[10] Allens, *Class Action Risk 2020 Report*, (March 2020) 10, 12. https://www.allens.com.au/globalassets/pdfs/campaigns/class_action_risk_report_2020.pdf.

[11] We discuss common fund orders in more detail in Section 3 below.

common law jurisdictions) and misleading and deceptive conduct.[12] Those consequences include the impact on the value of the investments of those shareholders (including the investments of the group members themselves) of the company at the time the company is the subject of the class action, and the impact on the availability of directors and officers insurance (D&O insurance) within the Australian market.

14 Our clients repeatedly tell us that continuous disclosure is a key focus for their boards which strive to do all that they can to ensure that their companies comply with their continuous disclosure obligations – both because of the imperative of complying with legal obligations and also because of the related class action risk. Indeed, we get the sense that the angst around this issue is resulting in an over-focus on continuous disclosure issues which is tying boards in knots.

15 In at least some cases, this over-concentration of focus and time on continuous disclosure issues is at the expense of consideration of other risks and also at the expense of pursuing the profit-making objectives of the company for the benefit of shareholders.

16 Moreover, a company that faces a class action (whether meritorious or not) will be required to divert significant resources and attention to the class action, to the likely detriment of the pursuit of shareholder value through operational activities. Companies often settle shareholder class actions because a settlement which eliminates its exposure and allows it to 'move on' is considered in the interests of the company when compared to the size of the potential exposure associated with an adverse judgment – this is usually the case irrespective of the strength of its defence. In these circumstances, simply being the target of a shareholder class action (irrespective of its merits) is likely to result in a significant outflow of funds from the company to litigation funders and plaintiff firms. While some of this amount may be covered by insurance, it is rare for insurance to cover the full amount. Our submission to the ALRC Inquiry also identified additional ways in which shareholder class actions undermine shareholder value aside from these significant transaction costs.[13]

17 These unintended consequences affect both the interests of the company itself and also the market more generally. By way of example, many companies have ceased to provide profit guidance in recent years. Boards that we speak to about stepping away from provision of guidance refer to the chilling effect that the prospect of a class action has on a board's appetite to provide investors with such information which is not mandated by law. This is particularly the case when directors face personal liability on a strict liability basis with no access to any defence for any breach of the continuous disclosure or misleading and deceptive conduct obligations, notwithstanding they may have undertaken due diligence and/or acted reasonably. Ultimately, investors are deprived of such information and the market is, counter-intuitively, less informed by the impact of the disclosure laws.

18 For these reasons, we continue to support the reform of the continuous disclosure regime and the private rights of action arising from a possible breach. The temporary reforms recently announced by the Australian Government may provide some comfort to companies deciding (as many have done) in the current uncertain economic environment not to release (or to withdraw) earnings guidance for fear of it being found later to be inaccurate. We note that the reforms effectively restore the fault elements of intent (knowledge), recklessness and negligence present at the time the continuous disclosure regime came into operation.[14]

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[12] ALRC, *Inquiry into Class Action Proceedings and Third-Party Litigation Funders Discussion Paper 85* (June 2018) 29 [1.73] (***ALRC Discussion Paper***).

[13] Allens ALRC Submission, 15-16 [44-46].

[14] The amendment removing the fault elements was made as part of the *Financial Services Reform Act 2001* (Cth). The stated purpose of the amendment was to ensure that the default fault elements under the Criminal Code would apply to offences for a

19 However, aside from the reforms being only temporary, there are some additional limitations to the announced measures. These include the following:

(a) The temporary modification only addresses the test for when particular information is regarded as being price sensitive. Under the unmodified test, civil liability arises where an entity fails to disclose non-public information and a reasonable person would expect that information, if disclosed, to have a material effect on share price or value.[15] Under the temporary modified test, civil liability arises where non-public information is not disclosed and the entity knows or is reckless or negligent as to whether that information would, if disclosed, have that price impact.[16] Accordingly, the modification does not assist a listed entity where its failure to comply with the continuous disclosure requirements is not due to a mistake about the price sensitivity of the information, but because of another fact. For example, where the company incorrectly takes the view that the information is too inherently uncertain to warrant disclosure; or where the information is known to one officer but not others. In other words, the temporary modification only provides protection from a breach of the continuous disclosure laws where the failure was due to an innocent (and non-negligent) mistake about price impact and does not provide protection for any other form of innocent breach.

(b) The unmodified test requires listed entities to disclose non-public information that a 'reasonable person' would expect to have a material effect on share price or value. Under the temporary modified test, non-public information need only be disclosed if the entity 'knows or is reckless or negligent' as to whether that information would, if disclosed, have that price impact. The inclusion of a negligence standard, rather than only the subjective fault elements of knowledge and recklessness, retains the objective 'reasonable person' element of the unmodified test, because the standard test for negligence also hinges on what a 'reasonable person' would expect. As such, there is a real question whether the temporary amendment provides any material protection from civil liability compared to the unmodified test.

(c) The unmodified standard of disclosure continues to apply for the purposes of any criminal offences based on subsection 674(2) or subsection 675(2) of the Corporations Act, so as a practical matter entities and their directors and officers must continue to comply with the unmodified provisions or risk committing a criminal offence.

(d) The modification does not assist a listed entity with claims under section 1041H of the Corporations Act for misleading and deceptive conduct; for example, where a listed entity has made a statement which constitutes an ongoing representation that is incorrect, but then it omits to update the market. In such a case, there is no requirement that the company be found to have exercised any degree of intentional concealment, recklessness or negligence.

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failure to comply with the continuous disclosure provisions. However, as the provisions are also civil penalty provisions, a consequence of the removal of the fault elements was the introduction of strict liability for civil penalties. It is unclear whether this was an intended consequence of the amendment, as the Explanatory Memoranda to the Bill did not refer to the impact of the removal of the fault elements on civil liability.

[15] Prior to its temporary modification, section 674(2) of the Corporations Act provided that if a listed entity has information that it is required to notify to the market operator and that information is not generally available and it is information that a reasonable person would expect, if generally available, to have a material effect on the price or value of ED securities of the entity, that entity must notify the market operator of that information.

[16] Section 674(2) now provides that if a listed entity has information that it is required to notify to the market operator and that information is not generally available and that entity knows, or is reckless or negligent with respect to whether that information would, if generally available, have a material effect on the price or value of ED securities of the entity, the entity must notify the market operator of that information.

20 The Australian Government's recent focus on the continuous disclosure regime and its impacts on vulnerable businesses during the COVID-19 pandemic is welcome. Our view is that this review of the operation of the continuous disclosure regime and private rights of action and their impacts on the Australian economy should continue post-COVID-19 in a more comprehensive and permanent way. This should see, in our view, an appropriate 'fault' based regime incorporated in respect of the disclosure obligations (namely, intention (knowledge) and recklessness) and harmonisation of other disclosure standards, including, where appropriate, inclusion of a due diligence defence (reasonable inquiries and reasonable belief) that is reflective of the prospectus disclosure defence.

21 Further, we continue to support amendments to the private rights of action with a view to limiting that right to those shareholders who have truly suffered loss by reason of the alleged conduct. Such amendments should aim to achieve a more appropriate balance between the disclosure obligations of listed entities and the consequences that can flow from getting the disclosure wrong.

Section 2: The Regulation and Oversight of the Litigation Funding Industry and Litigation Funding Agreements

1 The following items in the inquiry's Terms of Reference raise issues in relation to the regulation of litigation funders:

(a) the regulation and oversight of the litigation funding industry and litigation funding agreements;

(b) the Australian financial services regulatory regime and its application to litigation funding;

(c) the impact of litigation funding on the damages and other compensation received by group members in class actions funded by litigation funders;

(d) the financial and organisational relationship between litigation funders and lawyers acting for plaintiffs in funded litigation and whether these relationships have the capacity to impact on plaintiff lawyers' duties to their clients; and

(e) factors driving the increasing prevalence of class action proceedings in Australia.

Introduction

2 It has been Allens' position for some time that regulation is required to manage and counter the risks inherent in funded class actions, given the increasing prevalence of litigation funding, the types of funders entering the market (including overseas funders), and the conduct we are seeing in funded claims.

3 In particular, from our 'behind the scenes' vantage point in acting for defendants in a broad range of class actions, we have become increasingly concerned that the entrepreneurial forces are developing in a way that is resulting in an increasing number of instances of conduct that appears to prioritise the interests of the lawyers and/or funders over the interests of group members. While group members may still be better off because a claim has been brought on their behalf and they may receive an 'acceptable' return, the prioritisation of lawyer and/or funder interests is detrimental to both group members and defendants.[17]

4 For these reasons, we welcome the Australian Government's recent announcement of the regulation of litigation funders.[18] For completeness, we do not agree with the final recommendation in the ALRC Inquiry's report that court supervision is an appropriate alternative.[19] In our view, while court supervision remains important and necessary, it is not by itself adequate to address the broader concerns with the industry that have been identified in previous inquiries.

5 Against this backdrop, our submissions below address matters related to the proposed licensing regime, together with other proposals which would provide increased oversight of litigation funding.

Proposed licensing regime

6 Litigation funders currently benefit from exemptions to the *Corporations Regulations 2011* (Cth) (***Corporations Regulations***) which mean that funding arrangements are not categorised as managed investment schemes and funders are not required to hold an AFSL. Our understanding of the Australian Government's announcement is that it proposes to terminate the current

[17] We provided examples of this conduct in the Allens ALRC Submission at 19.

[18] The Hon Josh Frydenberg MP, 'Media Release: Litigation funders to be regulated under the Corporations Act' (22 May 2020).

[19] ALRC, *Integrity, Fairness and Efficiency – An Inquiry into Class Action Proceedings and Third-Party Litigation Funders: Final Report* (December 2018) 163 [6.42] (***ALRC Report***).

exemptions. As the law stands, this would mean that litigation funders would be required to hold an AFSL and funding agreements would need to be registered as managed investment schemes, and would be subject to Chapter 5C of the Corporations Act.

7 While we support the stated objectives of this reform, we consider that to ensure its effectiveness, further steps are required to tailor the AFSL and MIS regimes to the particular circumstances of litigation funding. Litigation funding is a unique category of financial product and the AFSL and MIS regimes were not developed with litigation funding in mind. It is also the case that the relationship between a litigation funder and group members is different to the relationships between other financial institutions and their clients. It is for these reasons that we have previously supported a bespoke licensing regime modelled on the AFSL regime.[20]

8 Specifically, in our view, there is a question as to whether a typical litigation funding agreement will be capable of being structured in such a way as to comply with the requirements for managed investment schemes in Chapter 5C of the Corporations Act, which means that some legislative or regulatory intervention to modify the application of Chapter 5C may be needed to ensure effective regulation of litigation funding agreements in Australia. We submit that any legislative or regulatory intervention should, at a minimum, require funders to hold an AFSL and be subject to Chapter 7 of the Corporations Act, and require that funding agreements be subject to certain minimum standards imposed by Chapter 5C. Overseas funders should also be subject to the regime in the same way as Australian funders.

9 The areas that are of particular concern to us in terms of appropriately tailoring the regime include financial adequacy, reporting obligations to ASIC and, most importantly, conflict management (which warrants particular consideration for the reasons set out in the following section).

10 We also consider that ASIC should play an important role in monitoring funders' compliance with the regime, and that appropriate funding needs to be given to ASIC to allow it to properly perform this role.

Conflict management

11 The conflicts that arise in the class action context are significant and pervading and pose the biggest challenge to the integrity of the class action regime. The lack of regulation and oversight of the litigation funding industry has enabled potential conflicts of interest to arise between the interests of litigation funders, plaintiff lawyers, the representative plaintiff and group members.

12 Direct conflicts are of course a significant issue.[21] However, we consider that to truly address these issues, it would be necessary for the conflict of interest requirements to address not only direct conflicts, but also more indirect sources of conflict that arise from the commercial drivers that influence the bringing and running of class actions. The issue that looms largest for us in this respect is the fact that third party funders are much more likely to be the 'repeat clients' of plaintiff law firms than the group members they represent. This makes preservation of the relationship with the funder important for the lawyer, and gives rise to the real risk (or at least temptation) that the interests of the funder will be preferred over the interests of the plaintiff and other group members.

13 Terms of the litigation funding agreement are often negotiated between the funder and the lawyer with little to no input from the representative plaintiff. Often, the interests of the funder and the

[20] Allens ALRC Submission, chapter 3.

[21] For example, we are increasingly seeing plaintiff solicitors, who are meant to represent the interests of the class, submitting that the court does not have the power to reduce the funding commission rate even if it decides the commission is not fair to group members: see, for example, *Earglow Pty Ltd v Newcrest Mining Limited* [2016] FCA 1433 at [148]-[158] and *Liverpool City Council v McGraw-Hill Financial, Inc (now known as S&P Global Inc)* [2018] FCA 1289 at [21].

lawyer are not aligned with the interests of the representative plaintiff and group members at the time of negotiating the funding agreement. The litigation funder's primary interest is maximising its potential return on investment. The plaintiff law firm has an interest in securing funding for the claim so that the proceeding may commence and the funder may start paying its legal fees. As such, the terms of the funding agreement may not adequately represent the best interests of the representative plaintiff and group members, particularly insofar as it relates to managing conflicts of interests and exposure to costs.

14 All of these issues mean that the existing conflict management requirements are unlikely to be sufficient for the unique conflicts that arise in the context of litigation funding.[22] This is something that will need to be given detailed consideration as part of any legislative or regulatory intervention to tailor the operation of the standard provisions.

Court supervision of litigation funders

15 As previously stated, we consider that, alongside regulation, courts have an important role to play in the oversight of funded class actions and consider that the further reform addressed below is required.

Commissions and fees

16 The lack of oversight of the litigation funding industry has exposed litigants to disproportionate costs and we are concerned about the proportion of settlements that are being paid to lawyers and funders. This is not fully addressed by the Australian Government's changes to the licensing regime.

17 As part of the court's supervisory jurisdiction, we consider it appropriate for the court to have an express statutory power to review and vary the funding commission rate as part of a settlement approval, if the court considers that rate to be disproportionate or excessive in all the circumstances of the case. We note that both the ALRC Inquiry and VLRC Inquiry recommended the introduction of a statutory power.[23]

18 We do not, however, support the introduction of any statutory cap on funding commissions for the following reasons:

(a) There is a risk that the introduction of a statutory cap will actually increase fees. Rather than serving as a maximum, the statutory cap may become seen as a default rate, with plaintiff solicitors and funders only decreasing their rates well below the capped amount in cases where there is a risk they will be undercut (for example, where there is a competing class action).

(b) A statutory cap may also serve as an unhelpful 'anchoring point' in settlement discussions and may scupper such discussions. For example, if the plaintiff lawyer and/or funder have a minimum amount they need to recover from the class action, they may seek to put pressure on the defendant to agree to a settlement that meets their expectations but also complies with the cap.

Overarching obligations and costs

19 To recognise the role funders play in class actions and ensure fair and equitable outcomes for group members, we consider that section 37N of the *Federal Court of Australia Act 1976* (Cth)

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[22] We note that currently, ASIC Regulatory Guide RG 248 and regulation 7.6.01AB of the Corporations Regulations contain conflict management obligations and guidance that applies to litigation funders. Our view is that these have been ineffective in regulating the behaviour of litigation funders to date, and we are not aware of any action taken by ASIC to enforce the obligations.

[23] ALRC Report, 169, Recommendation 14; VLRC, *Access to Justice – Litigation Funding and Group Proceedings: Report* (March 2018), 123, Recommendation 24 (***VLRC Report***).

(***Federal Court Act***) should be amended to require third party litigation funders to act in a way that is consistent with the overarching purpose in section 37M. A similar approach has already been adopted in section 11 of the *Civil Procedure Act 2010* (Vic).

20 We also consider that section 43(3) of the Federal Court Act should be amended to expressly give the Court the power to order costs against third party litigation funders. This may be appropriate, for example, where a litigation funder has acted contrary to the overarching purpose.

Supervision and regulation of relationship between lawyers and litigation funders

21 As set out above, the relationship between lawyers and funders in class actions gives rise to potential direct and indirect conflicts. To better manage these issues, we consider that the below additional measures should be introduced.

Additional disclosure requirements

22 Amendments to the Federal Court's Practice Note on Class Actions (GPN-CA) to include obligations on the representative plaintiff's solicitors:

(a) to disclose to the Court at the first case management conference any potential conflicts of interest that may affect their ability to act in the best interests of the representative plaintiff and/or the class (arising from the funding arrangements or otherwise), including:

(i) any commercial or personal relationship between the solicitors and any litigation funder; and

(ii) any retainer, contractual relationship or informal reciprocal arrangement between the solicitors and the litigation funder (or their respective associated entities);

(b) to notify the Court if any new conflicts or potential conflicts arise after the first case management conference; and

(c) to disclose to the Court the funder's conflict management policy at the same time that the litigation funding agreement is disclosed.

23 In our view, the above is consistent with the Court's existing supervisory roles with respect to solicitors' ethics and duties and protection of group members.

Solicitors' Conduct Rules

24 We also consider that the Australian Solicitors' Conduct Rules should be amended to prohibit solicitors and law firms from having financial or other interests in a third party litigation funder that is funding the same matter in which the solicitor or law firm is acting. As recognised by the Supreme Court of Victoria in *Bolitho v Banksia Securities Limited*, in such cases there is a much greater risk that the solicitor will not bring, or be seen to bring, the necessary objectivity that their role demands.[24]

25 The prohibition should also be extended to other arrangements that do not necessarily amount to a pecuniary or other interest in the litigation funder, but which nonetheless may give rise to the likelihood that plaintiff or group member interests may be de-prioritised over the interests of the funder. This may include reciprocal commercial arrangements.

[24] [2014] VSC 582 at [53].

Section 3: The Application of Common Fund Orders in Class Actions

1 The following items in the inquiry's Terms of Reference raise issues in relation to common fund orders:

(a) the application of common fund orders and similar arrangements in class actions;

(b) the impact of litigation funding on the damages and other compensation received by group members in class actions funded by litigation funders; and

(c) factors driving the increasing prevalence of class action proceedings in Australia.

Introduction and overview

2 It is our view that common fund orders and similar arrangements should not form part of Australia's class action regime.

3 The High Court in *BMW Australia Ltd v Brewster; Westpac Banking Corporation v Lenthall* (2019) 374 ALR 627 (***BMW Australia/Westpac***) confirmed that there is no power to make common fund orders under the current regime. As a matter of policy, we oppose any legislative intervention which would alter this position.

4 In short, we consider that common fund orders do not facilitate fair and equitable outcomes for plaintiffs. They enable litigation funders to profit from the claims of group members, even if the group members themselves have no desire to pursue their claims and often without the consent of group members. As such, common fund orders encourage the proliferation of litigation; not for the benefit of the parties to the litigation or to assist the court in determining any issue in dispute between the parties to the proceeding, but for the benefit of litigation funders.

5 In addition, common fund orders:

(a) have led to an increase in multiple litigation funders commencing 'competing' open class actions in which multiple law firms/funders file class actions concerning identical or similar alleged misconduct on behalf of largely (if not entirely) the same group members, leading to an increase in the expense and delay of class actions;

(b) require courts to engage in the speculative exercise of determining the appropriate commercial return for litigation funders, which should not be a task for the court, whose role is to determine the issues in dispute between the group members and the defendant;[25] and

(c) may not be permitted under the Commonwealth Constitution, at least insofar as they relate to proceedings seeking relief under Commonwealth legislation or in Commonwealth courts.[26]

6 We acknowledge that both the ALRC Inquiry and the VLRC Inquiry supported a statutory power for courts to make common fund orders.[27] For the reasons set out above and below, we disagree

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[25] In the judgment of Kiefel CJ, Keane and Gordon JJ in *BMW Australia/Westpac* at [50], it was held that: '*as a matter of the ordinary and natural meaning of these words* [the words of section 33ZF of the Federal Court Act], *they authorise an order apt to advance the effective determination by the court of the issues between the parties to the proceeding. Whether or not a potential funder of the claimants may be given sufficient financial inducement to support the proceeding is outside the concern to which the text is addressed*.'

[26] In the judgment of Edelman J in *BMW Australia/Westpac* at [229] it was stated that '*It might be doubted whether s 183 of the* [NSW] *Civil Procedure Act should be characterised in a manner that would require it either never or always to be picked up by s 79 of the* Judiciary Act.'

[27] ALRC Report, 96, Recommendation 3; VLRC Report, 131, Recommendation 27.

with those recommendations. We also note that those recommendations were made in the context where courts had found that class action legislation allowed such orders to be made and such orders were being made on a regular basis.

Common fund orders

7 When a common fund order is sought, a litigation funder is effectively proposing to the court that:

(a) they will fund a class action in the court; if, in return

(b) the court orders (in substance) that every group member (regardless of whether they provide consent) pay a share of any judgment or settlement to the litigation funder.

8 In the end, the funder stands to receive a sum far larger than the amount they are contractually entitled to receive under the litigation funding agreements which they have entered into.

9 When a court makes a common fund order, the court crafts a relationship between those group members who have not signed litigation funding agreements and the litigation funder who is not a party to the proceeding. By crafting this relationship, the court is conferring a benefit on a litigation funder (and in turn imposing a burden on group members) to which it has no pre-existing entitlement in contract or at law. The size of the benefit conferred by the court can be in the tens of millions of dollars. The court is also imposing a burden on group members collectively which did not exist before the making of the common fund order.

10 Common fund orders appeal to many litigation funders because, by avoiding the need to enter into litigation funding agreements (by engaging in a book building exercise), they can:

(a) profit from the claims of group members who have no grievance and/or no desire to pursue a claim and who have not consented to the funding terms; and

(b) bring a class action as soon as they can identify one group member willing to lead the class (with the belief that at least six more claimants have similar claims).

11 Because of these features, common fund orders also facilitate multiple class actions being brought in relation to the same underlying complaint.

Responses to arguments in favour of common fund orders

Common fund orders do not increase access to justice

12 This argument is based on a misunderstanding of what is meant by 'access to justice'.

13 The objectives of Part IVA of the Federal Court Act were identified by the ALRC prior to its enactment. They were twofold: first, to enhance access to justice for claimants by allowing for the collectivisation of claims that might not be economically viable as individual claims; and secondly, to increase the efficiency of the administration of justice by allowing a common binding decision to be made in one proceeding rather than multiple suits.[28]

14 The plurality judgment of the High Court in *BMW Australia/Westpac* identified that the defects in the existing law targeted by the ALRC in order to improve access to justice simply did not include the absence of sufficient incentive for litigation funders to fund litigation.[29] The plurality considered that to be:

> significant given that the ALRC was alive to the possibility that a representative proceeding might be funded by third parties. The possibility that a group proceeding might not be brought because a

[28] ALRC, *Grouped Proceedings in the Federal Court*, Report No 46 (1988) at [13], [18]; Australia, House of Representatives, *Parliamentary Debates* (Hansard), 14 November 1991 at 3174-3175.

[29] In the judgment of Keifel CJ, Keane and Gordan JJ in *BMW Australia Ltd v Brewster; Westpac Banking Corporation v Lenthall* [2019] HCA 45 at [83].

> litigation funder could not see the prospect of a sufficient return to support the proceeding cannot be said to be one of the "unforeseen difficulties" referred to by Wilcox J in McMullin. The ALRC's report did not advert to the possibility of enlisting the aid of the court to fix, even provisionally, the terms on which financial support for the bringing of a proceeding might be secured. It would have been a large step in terms of policy to enlist the court charged with responsibility for the determination of the merits of the claims brought in a proceeding, in the making of arrangements to allow the proceeding to be pursued. It is hardly surprising then that the Parliament refrained from taking that course.[30]

15 Access to justice can be a problem if a person who has a grievance which they wish to pursue in court is unable to pursue their claim – most commonly because of the expense of litigation (including the risk of an adverse costs order). There is no doubt that the class action regime and litigation funding can increase access to justice. Traditional litigation funding arrangements only require potential group members to sign a litigation funding agreement – an extremely low burden to access the court system.

16 The essential distinction between common fund orders and traditional forms of litigation funding is that, with a common fund order, the potential group members do not even need to take the very simple step of signing a litigation funding agreement. That is, common fund orders facilitate the bringing of proceedings on behalf of group members who do not or may not wish to pursue claims. If a person does not wish to pursue a claim, there is no 'access to justice' issue and there is no problem that is solved by the making of a common fund order.

17 The possibility that claims are not brought because they are not commercially viable to a third party litigation funder or because there is a lack of interest by potential claimants in pursuing the claim is not a reason for concern that the legislation is not operating as it should. It is not an objective of the class action regime to improve commercial outcomes for the litigation funding industry or to encourage plaintiffs to bring claims they otherwise have no desire to pursue.

18 Common fund orders make it very easy for a litigation funder to initiate a class action, as it is only necessary to engage with one potential group member. One would therefore expect that common fund orders increase, rather than decrease, the number of competing class actions. Recent experience bears this out: in the two years after the first common fund order being allowed in 2016 in the *Money Max* decision[31] the number of competing class actions filed increased significantly.[32] There has been a substantial increase in recent years in the number of competing class actions, an increase that has broadly coincided with the advent of common fund orders. Competing class actions have a number of undesirable consequences. They do not improve access to justice for group members, and only serve to benefit the plaintiff lawyers and funders.

19 As noted by the Chief Justice of the Federal Court when considering the competing AMP class actions:

> …the running of multiple actions by different lawyers, with different funders was, in principle, potentially inimical to the administration of justice and, in particular, potentially inimical to the interests of group members, and potentially oppressive to AMP.[33]

20 In most cases, there is little real justification for paying multiple sets of lawyers to run multiple claims, when group members could be effectively represented in a single claim by a single legal team. In this regard, we note that the majority of competing class actions occur in the shareholder

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[30] *BMW Australia/Westpac* at [83] (citations omitted).

[31] *Money Max Int Pty Ltd (Trustee) v QBE Insurance Group Limited* (2016) 245 FCR 191.

[32] Allens, *Class Action Risk 2018 Report* (November 2018) 3, 5. https://www.allens.com.au/globalassets/pdfs/insights/disputes-investigations/classactionrisk.pdf.

[33] *Wileypark Pty Ltd v AMP Limited* [2018] FCAFC 143 at [2].

class action context, no doubt because of the commercial opportunity presented by the scale and potential quantum of such claims. The economic impact of the increasing prevalence of shareholder class actions in Australia has been addressed in Section 1 of this submission.

21 Aside from the duplicated costs, in our experience, competing class actions have the potential to put both group members and defendants in an invidious position:

(a) for defendants, there are often significant additional costs in dealing with multiple sets of proceedings which often involve different (albeit overlapping) issues. Indeed, simply dealing with multiple sets of lawyers significantly increases the cost burden; and

(b) for group members, multiple claims give rise to confusion and, in cases where group members are asked to choose between claims, significant stress in being required to make a decision that many are ill-equipped to deal with. Moreover, the costs associated with multiple proceedings is likely to reduce overall group member recovery.

22 Competing class actions also impose an additional burden on the court in direct contradiction with one of the key objectives of the class action regime – to promote efficiency in the judicial system by dealing with a large number of claims arising out of the same of similar issues simultaneously.

Common fund orders do not result in lower commissions for litigation funders

23 If common fund orders did in fact result in lower commissions, they would not be so strongly supported by litigation funders. There are a number of reasons why common fund orders actually increase the *total amount* of commission paid by group members, including:

(a) the assertion that common fund orders lower commission rates ignores the effect of funding equalisation orders in open class actions. Under a funding equalisation order, the burden of paying the litigation funder is shared equally among all group members in proportion to the amount that they receive. Importantly, and unlike common fund orders, the total burden on group members is not increased, but is limited to the contractual obligations voluntarily incurred by those group members who entered into funding agreements. Although the 'headline rate' in a litigation funding agreement may be higher than the 'headline rate' in a common fund order, the actual amount paid by group members (after the funding equalisation order spreads this burden among all group members) will generally be much lower. Conversely, with a common fund order, although the 'headline rate' may be lower, a greater portion of the resolution sum is taken from each group member resulting in a far higher overall commission being received by the litigation funder. As noted by the plurality in *BMW Australia/Westpac*,[34] funding equalisation orders also address the 'free riding' argument commonly put forward by supporters of common fund orders (ie, that unfunded group members take the benefit of the costs and risks assumed by the representative plaintiff and funded group members); and

(b) there is no inherent reason why rates set by a court would be lower than rates set by the market. One of the most common form of class action is a shareholder class action, and the main beneficiaries of shareholder class actions are large corporate shareholders. These large shareholders are perfectly capable of using their market power to push down funding rates – particularly given the significant increase in the number of litigation funders recently entering the Australian market. In the AMP shareholder class action

[34] At [86].

proceedings, the commissions sought by some of the funders willing to finance the claim were as low as 8-10%.[35]

Common fund orders do not avoid the incurrence of the 'wasted costs' associated with a book build

24 Supporters of common fund orders claim that they avoid the incurrence of 'wasted costs' associated with identifying and contacting group members during a book build process. There is a fundamental flaw to this argument. At some point in all class actions where a settlement sum is paid or a judgment sum ordered, group members who wish to participate in that resolution sum are required to come forward and identify themselves. In order to facilitate group members coming forward to receive a portion of the resolution sum, the applicants (generally through a litigation funder) undertake an exercise of advertising the claim to identify relevant group members.

25 It therefore should not be thought that there is a benefit to facilitating ‘access to justice’ for those group members who are not sufficiently motivated to take any action at all to obtain redress for a perceived wrong. There is no practical model of ‘access to justice’ that involves remaining entirely passive. The class action regime requires that any group member wishing to obtain relief will eventually have to take at least some step to join in any successful outcome. Any suggestion that book building is an exercise in 'wasted costs' ignores this reality[36].

26 There is no flaw in the system that needs to be fixed by allowing common fund orders. The reality is that the class action regime was functioning effectively before common fund orders were devised, not least because book building was an efficient way of marshalling group members who were prepared to take the active steps required to benefit from any class action carried out in their name. The book building process is also valuable because it forms an important part of the promoter's pre-commencement due diligence on the merits and viability of the claims, and avoids a 'rush to the court'.

Common fund orders do not promote the resolution of the claims of all group members

27 It is argued that common fund orders are consistent with the 'opt out' model of the Australian class action regime as they encourage open class actions which facilitate the determination of the claims of all group members. It is argued that this is beneficial to defendants as open class actions mitigate the 'tail risk' exposure of subsequent or copycat claims. These arguments are, however, misconceived for the following reasons:

(a) litigation funders are willing to finance open class actions without common fund orders. This is apparent from the fact that funded class actions have continued to be launched and filed since the High Court decision in *BMW Australia/Westpac*, without the expectation of a common fund order;

(b) plaintiff law firms often pursue open class actions on a 'no-win no-fee' basis (which do not involve litigation funders or common fund orders); and

(c) as explained above, with the advent of common fund orders, we have observed a pronounced increase in the number of competing open class actions, prejudicing defendants with copycat claims and placing a strain on judicial resources.

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[35] See *Wigmans v AMP Ltd; Fernbrook (Aust) Investments Pty Ltd v AMP; Wileypark Pty Ltd v AMP Ltd; Georgiou v AMP Ltd; Komlotex Pty Ltd v AMP Ltd* [2019] NSWSC 603.

[36] *BMW/Westpac* at [94].

Common fund orders at settlement

28 There has been some discussion about whether the decision in *BMW Australia/Westpac* precludes a common fund order being made as part of the court's approval of a settlement. While we note that there has been some legal uncertainty amongst single Federal Court judges on this,[37] we think the preferred view is that of Justice Foster in the Volkswagen diesel emissions class action.[38] In that proceeding, Justice Foster said that the reasoning of the High Court in *BMW Australia/Westpac* probably did preclude a common fund order being made at settlement under s 33V of the Federal Court Act. We consider that the problems with common fund orders identified in *BMW Australia/Westpac* and in this submission apply equally at all stages of a class action proceeding, including settlement, and therefore common fund orders should not be allowed at any stage. Given the uncertainty, we consider that Parliament should take steps to confirm that common fund orders cannot be made at any stage of a class action.

[37] In *Fisher (as trustee for the Tramik Super Fund Trust) v Vocus Group Limited (No 2)* [2020] FCA 579 and *Uren v RMBL Investments Ltd (No 2)* [2020] FCA 647, single judges held that *BMW Australia/Westpac* does not preclude a common fund order as part of a settlement approval under s 33V of the Federal Court Act, although went on to note that the High Court had favoured the making of a funding equalisation order over a common fund order.

[38] *Cantor v Audi Australia Pty Limited (No 5)* [2020] FCA 637.

Section 4: Class Closure Orders

1 Class closure orders are orders made at the appropriate stage of a proceeding (which differs from case to case) requiring group members to take the positive step of registering their interest in participating in the proceeding. The usual order made is that the group members who do not register by the designated dates will remain group members, and therefore have their claims extinguished by the class action, but will not be entitled to participate in any settlement.

2 We consider that class closure orders are an important aspect of the class action regime because they facilitate settlement and allow finality to be achieved for both the group members and the defendant.

3 In this regard, we consider that Part IVA of the Federal Court Act should be amended to include an equivalent provision to s 33ZG of the Supreme Court Act which expressly permits the making of a class closure order. This legislative amendment would address the concern as to the power of the Federal Court to close the class. As Professor Morabito has noted:

> In 2000 the ALRC had a similar concern as to the power of the Federal Court to close the class. In light of the ALRC's positive assessment of such a practice, it recommended an amendment to Part IVA to enable the Federal Court to 'close the class at a specified time before judgment'. This recommendation appears to have been accepted by the Victorian legislature.[39]

4 The legislative amendment would be particularly timely given the recent decisions of the Court of Appeal of the NSW Supreme Court[40] in which the Court held that the cognate provision of s 33ZF of the Federal Court Act[41] provides no power to make a class closure order. These decisions directly conflict with, and cast doubt upon, the long-standing acceptance by the Federal Court that s 33ZF permits the making of a class closure order.[42]

5 In our view, the decisions of the NSW Court of Appeal overstate the concern that class closure orders undercut the opt-out rationale underpinning class proceedings. A class closure order is not granted as of right, but as a matter of judicial discretion. A court must take into account the interests of the class as a whole in requiring group members to take steps to facilitate settlement; the complexity and likely duration of the case; the attitude of the parties; and the point that the case has reached. Indeed, the most recent Federal Court decisions following the decisions of the NSW Court of Appeal aptly demonstrate that class closure orders are often made by consent.[43] Moreover, a class closure order is typically expressed to be a 'soft' closure in the sense that if an 'in principle' settlement were not achieved before the commencement of the trial, the unregistered group members' rights would remain unextinguished and they could participate in any distribution upon judgment.

6 In our experience, settlement discussions would likely stall without class closure orders made by the court. The orders are critical to facilitating settlement negotiations because they assist both sides to understand the total quantum of group members' claims and permit the settlement

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[39] Morabito, 'Judicial Responses to Class Action Settlements That Provide No Benefits to Some Class Members' (2006) 32(1) *Monash University Law Review* 75 at 104, citing ALRC, *Managing Justice – A Review of the Federal Civil Justice System*, Report No 89 (2000) at [7.122].

[40] *Haselhurst v Toyota Motor Corporation Australia Ltd* [2020] NSWCA 66; *Wigmans v AMP Ltd* [2020] NSWCA 104.

[41] *Civil Procedure Act 2005* (NSW) s 183.

[42] *Newstart 123 Pty Ltd v Billabong International Ltd* (2016) 343 ALR 662 at [67]-[68]; *Melbourne City Investments Pty Ltd v Treasury Wine Estates Ltd* (2017) 252 FCR 1 at 20-23 [70]-[80].

[43] See, eg, *Inabu Pty Ltd as trustee for the Alidas Superannuation Fund v CIMIC Group Ltd* [2020] FCA 510; *Fisher (trustee for the Tramik Super Fund Trust) v Vocus Group Ltd (No 2)* [2020] FCA 579.

amount to be capped by reference to the number of group members. Accordingly, we consider it desirable that the Federal Court's ability to make a class closure order be expressly included within Part IVA of the Federal Court Act.

Section 5: Contingency Fees

1 The following items in the inquiry's Terms of Reference raise issues in relation to the potential impacts of proposals to remove the prohibition on contingency fees:

(a) the potential impact of proposals to allow contingency fees and whether this could lead to less financially viable outcomes for plaintiffs;

(b) the financial and organisational relationship between litigation funders and lawyers acting for plaintiffs in funded litigation and whether these relationships have the capacity to impact on plaintiff lawyers' duties to their clients;

(c) factors driving the increasing prevalence of class action proceedings in Australia; and

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

Potential impacts of lifting the prohibition on contingency fees

2 Lifting the ban on contingency fees would be a significant, and, we believe, unwelcome, development for the profession and the legal system as a whole. We are therefore opposed to the current prohibition being lifted.

3 Those who support proposals to allow contingency fees often suggest that this will improve access to justice for plaintiffs because small to medium sized claims that are not seen to be financially viable by litigation funders will be brought by plaintiff firms, increasing competition and exerting downward pressure on funder commissions and leading to greater returns for group members. However, in our opinion, lifting the prohibition on contingency fees is unlikely to improve access to justice in the class action context and may lead to less financially viable outcomes for plaintiffs in claims that would otherwise have been run on a 'no win, no fee' basis.

4 Lifting the ban on contingency fees gives rise to potential conflicts of interest between the lawyer and the client that threaten the balance the High Court sought to achieve in *Campbells Cash and Carry Pty Ltd v Fostif Pty Ltd* when it allowed third party litigation funding in Australia.[44] In that case, the Court found third party litigation funding permissible because of the independent role of the lawyer as a bulwark for the client against the commercial interests of the third party litigation funder. Contingency fees also threaten to undermine the position held by the Court that a lawyer's financial interest in litigation may constitute an abuse of process.

5 If contingency fee arrangements are allowed in class actions, we believe that these arrangements must be subject to appropriate safeguards, introduced in a controlled manner and subject to approval (and ongoing close supervision) by the courts to avoid excesses and manage conflicts of interest between the lawyer and their client. It is also imperative that the 'loser pays' rule remains in place as a disincentive to the bringing of purely speculative claims.

Contingency fee arrangements are unlikely to improve access to justice

6 In the current entrepreneurial environment, characterised by increased class action filings and more lawyers and funders promoting class actions than ever before, we are not aware of any evidence that meritorious claims are not being brought due to a lack of funding.

7 Our view is that allowing lawyers to charge on a contingency basis will not have a material effect on case selection. This is because, in our experience, class actions suitable for funding on a

[44] See *Campbells Cash and Carry Pty Ltd v Fostif Pty Ltd* (2006) 229 CLR 386.

contingency fee basis are already being brought with the backing of third party funders or, alternatively, by lawyers on a 'no win, no fee' or other conditional fee basis. For example, the following small or mid-sized class actions were all run and settled on a 'no win, no fee' basis, without the backing of a litigation funder:

(a) the Bonsoy milk class action which settled for $25 million;[45]

(b) the Black Saturday bushfires case which settled for $494.7 million;[46]

(c) the hip implants class action which settled for $250 million;[47]

(d) the Cash Converters class action which settled for $16.4 million;[48] and

(e) the NAB consumer credit insurance class action which settled for $49 million.[49]

8 To the extent that a lifting of the ban on contingency fees may encourage the pursuit of claims that would otherwise not have been filed, there is a real risk that the additional claims that will be pursued will be those of a highly speculative nature, further increasing the prevalence of class actions in Australia. The economic impact of the increasing prevalence of class actions in Australia has been addressed in Section 1 of this submission.

9 We have previously raised in our submission to the VLRC Inquiry two ways in which we consider access to justice through funding arrangements may be improved – namely, through justice funds and reform of after the event insurance.[50]

Contingency fee arrangements are unlikely to lead to greater returns by group members

10 In our view, rather than improving access to justice in the class action context, introducing contingency fees will simply change the way some cases are funded, which may in turn lead to less financially viable outcomes for plaintiffs. We consider that permitting contingency fees is also unlikely to have a material impact on commission rates charged by litigation funders or to materially increase the overall return to group members.

11 It is likely that the main effect of introducing contingency fees is that small or mid-sized actions of the kind mentioned above would be pursued on a contingency basis rather than a 'no win, no fee' basis. This may well result in larger deductions from group members' returns should those proceedings be successful.

12 Recent developments in third party funding suggest that competition between third party funders (and court intervention) is already driving down the cost of funding. As noted above, the various shareholder class actions against AMP are a recent example of this, with certain funders agreeing to commission rates as low as 8-10% of net proceeds of the action.[51] In circumstances where solicitors acting on a contingency basis will consider that they are taking on the same risk as third party funders, there is little reason to expect that they would seek a percentage return that is materially lower than that which is currently being sought by third party funders.

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[45] *Downie v Spiral Foods* [2015] VSC 190.

[46] *Matthews v AusNet Electricity Services Pty Ltd* [2014] VSC 663.

[47] *Stanford v DePuy International Ltd (No 6)* [2016] FCA 1452.

[48] *McKenzie v Cash Converters International Ltd (No 4*) [2019] FCA 166.

[49] *Clark v National Australia Bank Limited (No 2)* [2020] FCA 652.

[50] Allens VLRC Submission, 14 [4.13-4.16].

[51] See *Wigmans v AMP Ltd; Fernbrook (Aust) Investments Pty Ltd v AMP; Wileypark Pty Ltd v AMP Ltd; Georgiou v AMP Ltd; Komlotex Pty Ltd v AMP Ltd* [2019] NSWSC 603.

Contingency fee arrangements risk conflicts of interest and may give rise to an abuse of process

13 Lifting the ban on contingency fees gives rise to potential conflicts of interest between lawyer and client in that lawyers may be incentivised to act for their own financial gain instead of in the best interests of their client. We have identified in Section 2 of this Submission the conflicts of interest that can arise as the result of a litigation funder's economic interest in the outcome of class action litigation and the need to regulate litigation funding arrangements to address those potential conflicts. These conflicts are significantly more pronounced in circumstances of lawyers funding litigation, having regard to the independent role of lawyers as a profession and their centrality to the administration of justice and the public's perception of the justice system.

14 Contingency fees give lawyers a direct financial interest in decisions affecting the litigation they are running. Contingency fees therefore have the real potential to undermine a lawyer's independent judgment and to give rise to conflicts of interest which are not present when lawyers are charging on a fee-for-service basis. For example, in a contingency fee arrangement, advice given to a client as to the timing and amount of a settlement may be influenced, or perceived to be influenced, by the direct financial benefit that lawyer might themselves obtain.

15 Removing the prohibition on contingency fees also has the potential to upset the balance the High Court sought to achieve in the class action regime when originally accepting the role of third party funders. In considering the validity of third party funding, the High Court was concerned that the decisions of funders may be influenced by conflicts of interest. However, it ultimately acknowledged that such a risk could be managed by the independence of the legal profession.[52] Such independence, and the balance sought to be struck by it, will be threatened if the ban on contingency fees is lifted.[53]

16 Contingency fees also threaten to undermine the position, long held by the courts, that a lawyer's financial interest in litigation that they are running may constitute an abuse of process, particularly where a proceeding is commenced for the purpose of generating revenue rather than for the benefit of the representative plaintiff and the group members.[54]

17 The conflicts of interest presented by lawyers charging contingency fees may impede access to justice and undermine public confidence in the administration of justice more generally.

Protections and safeguards if contingency fees are permitted

18 We recommend that, if the prohibition on contingency fees is lifted, courts be given the power to approve, reject or vary contingency fee arrangements. Contingency fee arrangements have the ability to give rise to potential conflicts of interest between the lawyer and the client and to undermine the position that a lawyer's financial interest in litigation may constitute an abuse of process.[55] Therefore, it is vital that courts retain jurisdiction to oversee and manage the conduct of lawyers in relation to contingency fee arrangements and the conflicts of interest that may arise.

19 In previous submissions, we have identified the important role that the courts have to play in managing class action proceedings, including management of any conflicts of interest.[56] We

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[52] See the minority decision in *Campbells Cash & Carry Pty Ltd v Fostif Pty Ltd* (2006) 229 ALR 58.

[53] These concerns are also reflected in *Melbourne City Investments Pty Ltd v Treasury Wine Estates Limited (No. 3)* [2014] VSC 340.

[54] See, e.g., *Bolitho v Banksia Securities (No 4)* [2014] VSC 582 and *Melbourne City Investments Pty Ltd v Treasury Wine Estates Ltd (No 3)* [2014] VSC 340; *Melbourne City Investments Pty Ltd v Myer Holdings Limited (No 2)* [2016] VSC 655; *Kelly v Willmott Forests Ltd (No 4)* [2016] FCA 323.

[55] Allens VLRC Submission, 12 [4.8-4.9].

[56] Allens VLRC Submission, 12-13 [4.11-4.12]; Allens ALRC Submission, 27 [56]-[58].

consider that permitting solicitors to take a direct commercial interest in the outcome of class action proceedings introduces a greater risk of conflicts arising between interest and duty which will need to be appropriately monitored and managed. If contingency fees are to be permitted, empowering and requiring courts to oversee these contingency arrangements proactively is an important check on the potential for conflicts to go unmanaged.

20 Following the VLRC Inquiry, the Victorian Government has adopted the VLRC's recommendation to lift the ban on contingency fees. The Justice Legislation Miscellaneous Amendments Bill 2019 is currently before the Legislative Council which, if passed, will permit the use of contingency fee arrangements in Victoria. If the current Victorian Bill is passed into law, the Supreme Court of Victoria would be empowered to make a 'group costs order' under which:

(a) the representative plaintiff's lawyers would be remunerated by reference to a percentage of any amount recovered, rather than being limited to recovering their fees plus an uplift; and

(b) liability for payment of the legal costs would be shared among the plaintiff and all group members (effectively, a common fund order).

21 Such an order could be made on application by the plaintiff in any class action if the court was satisfied 'that it is appropriate or necessary to ensure that justice is done in the proceeding'. The percentage of the amount recovered would be subject to approval by the court and the court would have the power to vary the order, including the percentage to be recovered by the lawyers, at any time during the proceeding.

22 If contingency fee arrangements are permitted, we support the Victorian Bill's granting of wide powers to the court to approve and vary contingency fee arrangements. We also support the accompanying amendments to ensure that the law practice charging the contingency fee would be liable for any adverse costs order and for providing security for costs, which would ordinarily be borne by the litigation funder.

23 However, the Victorian Bill does not adequately address the potential conflicts of interest and abuse of process that may arise as the result of a lawyer acting on a contingency fee basis, and does not limit the availability of contingency arrangements to particular types of class action claims. We have previously submitted that contingency fee arrangements should not be available in personal injury claims.[57] The inappropriateness of contingency fees for personal injury claims was acknowledged in the Terms or Reference of the VLRC Inquiry.[58] However, the VLRC ultimately recommended that personal injury claims should not be excluded.[59] Our view is that contingency fee arrangements are not appropriate in personal injury claims (in addition to criminal and family law claims). This is because of the unique nature of personal injury claims, including the limitations on the quantum of damages that can be recovered and the underlying purpose of the heads of damage available (for example, future loss of earnings and future care).[60]

24 Finally, we consider that if there is any lifting of the prohibition on contingency fees, the approach should be harmonised between jurisdictions, to prevent 'forum shopping' issues, with some jurisdictions being more lucrative for plaintiff lawyers than others.

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[57] Allens ALRC Submission, 31 [82-83].

[58] VLRC Inquiry, *Litigation Funding and Group Proceedings: Terms of Reference* (19 January 2017) 2.

[59] VLRC Report, 63, Recommendation 7.

[60] These concerns were raised in the ALRC Discussion Paper at 91 [5.42].