Law Council
OF AUSTRALIA

Treasury Laws Amendment (Measures for Consultation) Bill 2021: Litigation funders

The Treasury

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About the Law Council of Australia

The Law Council of Australia exists to represent the legal profession at the national level, to speak on behalf of its Constituent Bodies on national issues, and to promote the administration of justice, access to justice and general improvement of the law.

The Law Council advises governments, courts and federal agencies on ways in which the law and the justice system can be improved for the benefit of the community. The Law Council also represents the Australian legal profession overseas, and maintains close relationships with legal professional bodies throughout the world.

The Law Council was established in 1933, and represents 16 Australian State and Territory law societies and bar associations and Law Firms Australia, which are known collectively as the Council's Constituent Bodies. The Law Council's Constituent Bodies are:

- Australian Capital Territory Bar Association
- Australian Capital Territory Law Society
- Bar Association of Queensland Inc
- Law Institute of Victoria
- Law Society of New South Wales
- Law Society of South Australia
- Law Society of Tasmania
- Law Society Northern Territory
- Law Society of Western Australia
- New South Wales Bar Association
- Northern Territory Bar Association
- Queensland Law Society
- South Australian Bar Association
- Tasmanian Bar
- Law Firms Australia
- The Victorian Bar Inc
- Western Australian Bar Association

Through this representation, the Law Council effectively acts on behalf of more than 60,000 lawyers across Australia.

The Law Council is governed by a board of 23 Directors – one from each of the constituent bodies and six elected Executive members. The Directors meet quarterly to set objectives, policy and priorities for the Law Council. Between the meetings of Directors, policies and governance responsibility for the Law Council is exercised by the elected Executive members, led by the President who normally serves a 12 month term. The Council's six Executive members are nominated and elected by the board of Directors.

Members of the 2021 Executive as at 1 January 2021 are:

- Dr Jacoba Brasch QC, President
- Mr Tass Liveris, President-Elect
- Mr Ross Drinnan, Treasurer
- Mr Luke Murphy, Executive Member
- Mr Greg McIntyre SC, Executive Member
- Ms Caroline Counsel, Executive Member

The Chief Executive Officer of the Law Council is Mr Michael Tidball. The Secretariat serves the Law Council nationally and is based in Canberra.

Acknowledgement

The Law Council acknowledges the assistance of the Class Actions Committee of the Federal Litigation and Dispute Resolution Section (**Class Actions Committee**), and the Financial Services Committee, Corporations Committee and the Insolvency and Restructuring Committee of the Business Law Section in the preparation of this submission.

Introductory Comments

1. The Law Council welcomes the opportunity to provide this submission to the Treasury in response to the:

   (a) Exposure Draft Treasury Laws Amendment (Measures for Consultation) Bill 2021: Litigation funders (**Exposure Draft**);

   (b) related Exposure Draft Explanatory Materials (**Explanatory Materials**);

   (c) Exposure Draft Corporations Amendment (Litigation Funding) Regulations 2021 (**Exposure Draft Regulations**); and

   (d) related Explanatory Statement (**Explanatory Statement**)

   (together, the **Proposed Reforms**).

2. The Law Council notes that the Proposed Reforms have been drafted following the Parliamentary Joint Committee on Corporations and Financial Services' (**PJC**) report 'Litigation funding and the regulation of the class action industry' and the recent Treasury/Attorney General's Department Consultation Paper entitled 'Guaranteeing a minimum return of class action proceeds to class members'. In this submission, issue is not taken with the underlying policy that is sought to be pursued by the Proposed Reforms namely, to ensure that class action plaintiffs receive a 'fair and reasonable' distribution of gross settlements. Rather, concerns are expressed as to several aspects of the Proposed Reforms that are considered to require reconsideration.

3. The Law Council would appreciate the opportunity to discuss with Treasury the matters raised in this submission. The Proposed Reforms are wide ranging in their likely impact and the Law Council would strongly urge further thinking on the Proposed Reforms and amendment in light of the comments provided. The Law Council would also be willing to assist with engagement on changes to the drafting of the Proposed Reforms that might more readily help the Government to achieve its policy objectives.

Timeline for Consultation

4. At the outset of the submission, the Law Council notes the unusually short period provided for consideration of the Proposed Reforms. The seven-day consultation period does not provide stakeholders with sufficient time to consider the broader impacts of the Proposed Reforms and the many issues and unintended consequences arising from the proposed drafting.

5. It is critical that the Proposed Reforms receive proper consideration to ensure that they achieve their intended purpose without adversely affecting those class members it is intended to protect or corporate defendants, company directors and insurers.

Purpose of the Proposed Reforms

6. The Law Council notes that the Proposed Reforms are aimed in part at making sure class action plaintiffs receive a 'fair and reasonable' distribution of gross settlements in proceedings involving third-party litigation funders.

7. To determine whether a settlement is fair and reasonable, a rebuttable presumption is proposed whereby the court is instructed to assume that a return to class members of less than 70 per cent of the claim proceeds is not fair and reasonable. In addition, the court is only allowed, when approving a settlement, to consider the factors listed in proposed new subsection 601LG(3) of the *Corporations Act 2001* (Cth) (**Corporations Act**).

8. As outlined below, the Law Council opposes limiting the discretion of the court and the factors that it can consider when approving the settlement of a class action. There also appear to be drafting issues with the Proposed Reforms that result in a need for improved clarity to avoid unintended consequences and adverse outcomes for all stakeholders. As currently drafted, the Exposure Draft appears to have consequences extending beyond the class actions that seem to be the intended focus of the legislation. The ambiguities and complexities that the Exposure Draft proposes to introduce are likely to lead to substantial costs and more delays in class actions that will not serve genuine class action plaintiffs well nor corporate defendants, company directors and insurers.

9. Should the legislation be enacted in its current form, it will almost certainly generate significant 'satellite' litigation over the proper interpretation and effect of the meaning of numerous parts of the proposed provisions. This is an undesirable outcome for legislation.

10. Further, the inconsistencies and ambiguities may result in a greater frequency of multiple or duplicate class actions all of which will increase costs, increase demands on the court system, create delays and uncertainties and potentially increase required settlement amounts. These unintended consequences will be of concern not only to plaintiffs but also and more significantly to corporate defendants, company directors and their insurers who may find they are facing an increased number of class actions, increased costs and either having to pay more to settle class actions or not being able to settle class actions on terms as they may have wanted to and instead being forced to go to trial.

11. It is critical that the Proposed Reforms adequately consider important features of 'representative' litigation, including 'class actions' under Part IVA of the *Federal Court of Australia Act 1976* (Cth) or cognate regimes in most of the States' Supreme Courts.

Summary of drafting concerns

Closed class only

12. The Exposure Draft appears to require a claimant to agree in writing to become a member of the class action litigation funding scheme. In doing so, the Exposure Draft may have the consequence of seeing Australia's 'open' or 'opt-out' class action regime revert to multiple closed classes or a mixture of both closed and open class actions against the same defendant. This is an outcome that is unlikely to be desired by any stakeholders. It is not clear if this is an intended consequence of the Proposed Reforms.

13. In the event that there are multiple closed class actions, settlement for corporate defendants and their insurers may be more problematic. It may encourage the commencement of 'follow on, open, no win no fee class actions'. There may be multiple class actions commenced. That consequence would significantly prejudice corporate defendants, company directors and their insurers who would be faced with

multiple class actions, increased costs and a near impossibility of efficiently and cost effectively settling all actions.

14. These issues do not arise currently with the 'open' class action regime where usually only one class action proceeds and there is the opportunity of settling with certainty and finality.

Claim proceeds distribution method at the outset

15. In the Law Council's view, the requirements for there to be at the outset a claim proceeds distribution method which requires approval of the court has three significant difficulties:

    (a) *First*, and practically, it is almost impossible to accurately determine at the outset exactly what any claim proceeds distribution method may entail as that will very much depend on events that occur over time (such as which and how many members join the scheme, what their particular losses or categories of losses may be and what any settlement structure or options offered by the defendant(s) entails). Indeed, this was one of the very reasons the High Court in *BMW Australia Ltd v Brewster; Westpac Banking Corporation v Lenthall*,[1] indicated that common fund orders at an early stage of proceedings were not appropriate, as all of the factors relevant to considering whether such orders were fair and reasonable could not then be known. Another well known example of the complexities that can arise in trying to assess very complex proceeds distributions was seen in the Volkswagen diesel emissions class actions.[2]

    (b) *Secondly*, it will in all likelihood mean that any such method contained in the initial scheme documents will be of such a generic, non-specific nature whereby the court may grant interim early approvals that are then revisited when settlement parameters are known and the precise distribution method can be set out with more detail and certainty. This will likely result in the same situation as is currently experienced where the court's approval is required for any settlement which necessarily involves consideration of the fairness and reasonableness of the distribution method.

    (c) *Thirdly*, the distribution method currently is determined by the claimant's lawyers having regard to the best interests of all group members to whom they owe fiduciary duties, not by the funder. Requiring the claim proceeds distribution method to be devised and set out in the funder's scheme documents may not be in the best interests of all group members.

Definition of claims proceeds

16. The definition of 'claim proceeds' creates uncertainties as to whether it captures compensation or damages only and legal costs that may be awarded or agreed separately or legal costs borne by the funder as well as legal costs borne other than by the funder.

[1] [2019] HCA 45.
[2] *Cantor v Audi Australia Pty Limited (No. 6)* [2020] FCA 658.

Definition of class action funding scheme

17. The definition of class action litigation funding scheme may have the unintended consequence of bringing within its ambit actions not intended to be caught by the legislation, such as:

    - subrogation actions run by insurers;
    - multi-plaintiff individual actions such as those brought for the victims of bushfires and other such catastrophes;
    - cost-sharing arrangements between co-plaintiffs not bringing class actions; or
    - actions which are not class actions but where financial assistance is provided to one claimant, such as a liquidator where claims are funded by creditors.

Application to state courts

18. The Law Council suggests that careful consideration be given as to the constitutional validity of the Exposure Draft to the extent that it seeks to apply to state courts not exercising federal jurisdiction. In the time available for consideration of the Exposure Draft, the Law Council has not had the opportunity to consider this issue in detail.

Other matters

19. The Exposure Draft proposes to insert a new subsection 601GA(5) into the Corporations Act. The Law Council notes that a subsection 601GA(5) has already been notionally inserted into the Corporations Act through the Australian Securities and Investments Commission (**ASIC**) *Corporations (Chapter 5C – Miscellaneous Provisions) Instrument 2017/125*. Under that instrument, subsections 601GA(5) and (6) allow the constitution of a registered scheme to include a listing rule consistency provision. A new subsection number for section 601GA that is not already in use is required.

20. The wording of proposed paragraph 601LG(3)(c) could be improved by the addition of the following words: 'and performing their respective obligations under the agreement'. The paragraph would then read:

    (c) the risks accepted by the parties to the agreement by becoming parties to the agreement and performing their respective obligations under the agreement.

21. The Explanatory Materials also require amendment to describe the way the provisions in the Exposure Draft would operate. For example:

    (a) Parts of the Explanatory Materials suggest that the Exposure Draft will impose requirements on the content of litigation funding agreements, which is not the case. Rather, the Exposure Draft states that the constitution of the scheme must require the litigation funding agreement to meet content requirements.

    (b) There is a prescribed list of the only matters the court must consider in determining if a litigation funding agreement is fair and reasonable in proposed section 601LG. Some parts of the Explanatory Materials suggest that the court must always have regard to those matters but that is not the wording used in the Exposure Draft.

(c) The Explanatory Materials state that proposed section 1688 of the Exposure Draft will apply if a litigation funding agreement is entered into on or after the commencement of the legislation and the managed investment scheme becomes a class action litigation funding scheme 'on and after' commencement (the Exposure Draft uses 'on or after'). However, it will only apply if proceedings are also commenced in the court on or after commencement.

(d) The Explanatory Materials also refer to 'Schedule #' which presumably is a reference to Schedule 1 to the Exposure Draft as it only has one schedule, unless further schedules are also proposed.

22. With regard to the Exposure Draft Regulations, the purpose is to prevent lawyers having a material financial interest in a financial services licensee if the licensee provides funds or indemnities in relation to a litigation funding scheme. Relevant duties are only imposed on financial services licensees, if they provide funds or indemnities.

23. The understanding is that there are some litigation funds that do not hold their own Australian Financial Services Licence (**AFSL**) (for example, funders appointed as authorised representative under another entity's AFSL and the responsible entity of their litigation funding scheme may be a professional responsible entity for hire who may not be providing funds or indemnities). If this is the case, it may be that the Exposure Draft Regulations will not always be effective.

24. It is also a concern to the Law Council that the Exposure Draft Regulations appear to impose an obligation on a financial services licensee to regulate lawyers' conduct. Regulation of lawyers' conduct should be imposed through the legal profession laws.

25. The proposed regulation 7.6.04(2A) does not state which Corporations Act provision it is being made under. If it is meant to be a licence condition imposed on AFSL holders, then it should be part of regulation 7.6.04(1).

Policy Concerns

26. In addition to the specific drafting matters noted above, the Law Council is also concerned at a policy and rule of law level about the following matters.

Presumed minimum acting as a floor

27. The notion of a presumed minimum return may, in reality, operate as a floor for returns to members, that is, returns of 70 per cent will become the maximum default position rather than allowing the market to gravitate towards more competitive returns. Matters that may currently see returns of more than 70 per cent to members will start at 70 per cent and move down from there.

Limiting the court's discretion

28. The Exposure Draft when dealing with the fair and reasonable test seems to impermissibly, and potentially prejudicially, limit the matters the court may have regard to in making its discretionary determination about the claims proceeds distribution method or the return to members. It is one thing to say a court 'must' have regard to certain matters. However, it is quite another to say the court must 'only' have regard to the specifically listed matters. In the Law Council's view, this

unnecessarily fetters the court's discretion. It commits one of the cardinal errors of drafting which, in a dynamic market place, seeks to prescribe today matters which may or may not be relevant tomorrow rather than allowing courts to develop law along with the changing times and society's norms. The limitation may mean a court cannot have regard to a highly relevant matter. It may mean the report to be provided to the court may not be able to address a relevantly critical matter or the report may address the relevantly critical matter, but the court cannot have regard to it.

29. This may create injustices or may be prejudicial to defendants wishing to settle a class action on a specific basis but because of the particular circumstances, the court cannot have regard to the relevant matter.

Adverse consequences for corporate defendants, company directors and their insurers

30. A real concern about the Exposure Draft is that at one level it does not achieve its objective of making sure returns to members are fair and reasonable via the rebuttable presumption. Instead, this may see 70 per cent become a maximum. Further, due to its complexity of structure and cross-referencing definitions, it may in fact be prejudicial to corporate defendants, company directors and their insurers in that we may see:

    (a) a return to multiple closed class actions and combined with lawyer run no win no fee open class actions which will increase costs significantly and make settlement more difficult and uncertain;

    (b) settlement amounts being driven higher so funders reach a number that works with the 70/30 rule;

    (c) cases being run against defendants' wishes and despite best efforts to settle because the settlement amount proposed will not deliver a 70 per cent return to members; and

    (d) cases which would otherwise settle, not settling for low amounts (where for instance insurance moneys are largely used up) and so the 70/30 rule cannot be met with the result being that plaintiffs will pursue individual company directors including through to bankruptcy.

Effect on competition

31. The Law Council notes the potential effect on choice for the public and competition in the legal services and litigation funding markets whereby some funders may leave the market as a result of increasing costs. This will mean that only some of the larger class actions will be conducted and then only by the larger plaintiff law firms thereby cementing an oligopoly in that market and restricting consumer choice.

32. If a number of funders leave the market, as is likely if the Proposed Reforms become law, many genuine, socially valuable class actions will not be brought when they otherwise may have been. The regulators are not able to and should not be expected to fill the void. Third party funding of class actions can be of great value to society, not only by assisting victims of wrongful conduct to be compensated but as a means by which these entities are called to account.