

Attachment B: Supplementary Analysis

Proposed Litigation Funding Reforms

Background

In December 2017, the Government commissioned the Australian Law Reform Commission (ALRC) to conduct an inquiry into class actions and litigation funding. The terms of reference required the ALRC to consider, among other things, issues surrounding the fairness and efficacy of Australia's class actions and third-party litigation funding regimes, including the costs of class action proceedings, the distribution of proceeds and the absence of regulation to address the structure, operation and terms on which third-party funding entities participate in the Australian legal system. The ALRC's report was tabled in Parliament on 24 January 2019 and included 24 recommendations to federal, and state and territory governments, the Federal Court of Australia (Federal Court) and the legal profession.

In May 2020, the Government referred an inquiry to the Parliamentary Joint Committee on Corporations and Financial Services (PJC) to further scrutinise the class action regime and the litigation funding industry. The referral was made to enable the ALRC's recommendations to be tested and refined, while providing an additional evidence base for legislative changes. In particular, the PJC inquired into whether the present level of regulation, practices and procedure applying to Australia's growing class action and litigation funding industry is appropriate and whether it is delivering fair and equitable outcomes for class members. The PJC's report was tabled in Parliament on 21 December 2020 and included 31 recommendations to the Australian Government, the Federal Court, and legal associations responsible for developing solicitor and barrister conduct rules.

The ALRC and PJC's findings relevantly included the following:

- the ALRC found that when litigation funders were involved in a class action, the median return to class members was 51 per cent, compared to 85 per cent when a funder was not involved
- the PJC found litigation funders are, systemically and inappropriately, obtaining windfall profits at the expense of class members.

Policy proposal

The policy proposal seeks to respond to a range of ALRC and PJC findings and recommendations concerning litigation funding practices in the class action industry. The relevant recommendations are set out in the Appendix to this paper.

Supplementary analysis

The ALRC and PJC reports include significant analysis, supported by extensive consultation, as outlined below. Treasury and the Attorney-General's Department have certified the reports address the first six Regulatory Impact Statement (RIS) questions set out in *The Australian Government Guide to Regulatory Impact Analysis* (the RIS Guide) for most elements of the policy proposal. These elements propose to implement the PJC and ALRC recommendations in substantially the same form as set out in the reports.

However in some cases, the policy proposal varies, extends or adds to the PJC and ALRC recommendations, based on the PJC and ALRC's findings or additional consultation undertaken by the Government.

These proposed variations, extensions or additions include:

- regulating the availability of Common Fund Orders (CFOs) with respect to litigation funding agreements
- clarifying court powers to approve or vary the funding distribution method included in funding agreements for a class action litigation funding scheme
- introducing a rebuttable presumption with respect to the maximum proportion of the class action proceeds associated with a class action litigation funding scheme which can be distributed to non-members of the scheme
- requiring courts to consider the report of a referee or views of a contradictor where one is appointed, unless it is not in the interests of justice to do so, and requiring the funder to cover the reasonable costs of the referee and contradictor, unless a court orders otherwise
- extending the application of certain recommendations beyond proceedings in the Federal Court, to proceedings commenced in State and Territory courts
- addressing conflicts arising when a lawyer for a class action litigation funding scheme (or close associate) holds a material financial interest in the funder.

In accordance with the Australian Government's approach to the certification of independent reviews, this paper provides analysis to supplement the PJC and ALRC analysis for these aspects of the policy proposal, consistent with the RIS Guide. It also seeks to respond to the seventh question in respect of the whole policy proposal.

The analysis in this paper is supported by the analysis included in the PJC and ALRC reports and stakeholder feedback to the Government's consultations on various aspects of the proposals in June and September 2021. Further detail on the consultations is set out below. Feedback from the consultations has been referred to where relevant in this paper.

Consultation

ALRC and PJC inquiries

The ALRC's inquiry included multiple rounds of consultation:

- early consultation with several government agencies, academics, judges, members of the legal profession, insurers and industry stakeholders within Australia and internationally
- consultation on a discussion paper on which it received 107 submissions, including from litigation funders and funding associations, law firms and legal associations, companies, industry associations, consumer groups, regulators and academics
- further consultations and workshops after receiving submissions, to ensure interested parties could expand on matters that had been raised in their submission and comment on new matters that had not previously been canvassed in the discussion paper
- a series of consultations with relevant stakeholders in England and Wales.

The ALRC also received assistance from two expert panels that were established for the inquiry.

The PJC sought submissions in response to its inquiry and subsequently received 101 submissions from a broad cross section of stakeholders. These included litigation funders and litigation funding associations, class action litigation law firms, law societies and legal associations, non-profit law and

policy organisations, companies, industry peak bodies, regulators, academics and individuals. The PJC also held public hearings at which it heard evidence from stakeholders.

Government consultation on design elements of a guaranteed statutory minimum return to class members

On 1 June 2021, the Treasurer and Attorney-General released a joint consultation in response to recommendation 20 of the PJC report. The consultation was on possible design elements of a statutory guaranteed minimum return of class action proceeds to class members. In particular, the consultation sought views on:

- the best way to guarantee a statutory minimum return of the gross proceeds of a class action (including settlements)
- whether a minimum gross return of 70 percent to class members, as endorsed by some class action law firms and litigation funders, is the most appropriate floor
- whether a graduated approach taking into consideration the risk, complexity, length and likely proceeds of the case is appropriate to ensure even higher returns are guaranteed for class members in more straightforward cases.

Treasury and the Attorney-General's Department received 22 submissions in response to the consultation, including from litigation funders, litigation funding associations, legal associations, law firms and legal practitioners, industry bodies and companies with experience as defendants.

Government consultation on a policy design

Using feedback from its June 2021 consultation, the Government developed proposed reforms to the corporations law to address the concerns raised by the ALRC and PJC. In September 2021, the Government released an exposure draft of the proposed reforms for consultation. Treasury and the Attorney-General's Department received 19 submissions in response to the consultation, including from litigation funders, litigation funding associations, legal associations, law firms and legal practitioners and industry bodies. Feedback from this consultation was used to inform the final design of the policy proposal.

Supplementary analysis of relevant elements of policy proposal

1. Regulating the availability of Common Fund Orders

This element of the policy proposal varies PJC recommendation 7 and ALRC recommendation 3 in addressing the problem of ‘free-riding’ in open class actions. Free-riding occurs where class members who have signed a litigation funding agreement are required to contribute to the costs of the class action under the terms of the agreement, but class members who have not signed the agreement would benefit from the outcome of the class action (e.g. a settlement or judgment award) without making a similar contribution.

The PJC and ALRC explored the range of mechanisms devised by the Federal Court to address this issue and both concluded government intervention was required. Multiple policy options were canvassed with various stakeholders during the course of the two reviews to address this problem.

The two main options considered by Government were whether CFOs should be expressly legislated for in this policy proposal or expressly prohibited, noting the availability of other mechanisms that allow the court to ensure all members benefiting from a class action contributed to its running costs. The costs and benefits of these two options were covered in the PJC’s report (paragraphs 9.47 – 9.95) and ALRC report (paragraphs 4.27-4.35).

Reasons for recommending this proposal

The Government’s position is that it is desirable to ensure that the Federal Court is properly empowered to make sure that all beneficiaries of a judgment or settlement contribute to the costs of the class action (i.e. to avoid the free-rider problem). To do this, the Government proposes to legislate that a litigation funding agreement is not enforceable and has no effect unless the court does not make a CFO.

The Government proposes this approach noting that the courts have already developed other mechanisms such as funding equalisation orders (FEOs) to address the free-rider concerns raised by the ALRC and PJC. A FEO enables the Court to ensure that the burden of costs associated with class action litigation is equitably shared amongst those who gain a financial benefit from the action.

The PJC recommended CFOs over maintaining the status quo of using FEOs as it noted it remained unclear whether FEOs could be used to modify a litigation funder’s commission rates. Likewise, the ALRC cited that one of the reasons it was supportive of CFOs was that they would support its recommendation that courts have an express statutory power to reject, vary, or amend the terms of a third-party litigation funding agreement.

As set out in section 2 below, the Government proposes an explicit statutory power for the courts to amend a funder’s commission rate. This would complement the power of a court to use a FEO to address the free-rider problem whilst addressing concerns raised by the PJC of windfall profits to litigation funders by allowing them to multiply out their commission rate across members of the class who have not agreed to join the funding agreement. The plurality in *BMW Australia Ltd v Brewster* [2019] HCA 45 (*Brewster*) considered that FEOs were a better way of equitably spreading costs to address the free-rider problem and noted that CFOs actually imposed an additional cost on the group. The plurality noted that FEOs had the benefit of taking, as their starting point, the actual costs incurred in litigation.

Endorsing CFOs in addition to this would have overlapped with the policy intention of this proposal and the courts' current FEO powers. Jointly, these the proposed policy and current FEO powers provide a solution to the free-rider problem but prevent windfall profits to litigation funders.

The Government is also concerned about significant legal concerns that have been identified about the use of CFOs. CFOs impose a litigation funding commission on class members who have not expressly signed up to a litigation funding agreement. This contravenes the fundamental common law doctrine of 'privity of contract', where the rights and obligations of a contract are only extended to those who are party to it. The majority in *Brewster* noted that unfunded group members have no contractual or other relationship with the funder nor have any liability to the funder. The funder has no right to claim a commission from these members under contract or under equitable principles unless one is created under a CFO.

One of the key issues that remains outstanding in relation to CFOs is the uncertainty surrounding the courts power to make such an order. This uncertainty arose after the High Court in *Brewster* considered the question of whether the Federal Court and Supreme Court of NSW had the power to make a CFO. The High Court held that CFOs were not available at an early stage of a class action proceeding. However, the decision left uncertain if CFOs were available at the settlement stage of proceedings. The PJC noted this uncertainty was exhibited by divergent views expressed in subsequent decisions of the Federal Court and raised by several stakeholders in their submissions to the inquiry. The proposed approach would resolve this uncertainty and clarify the position on CFOs.

The proposed approach also specifies membership of a class action litigation funding scheme (which the proposal defines as a managed investment scheme (MIS)) consists of only a claimant in the relevant class action. This clarifies existing market uncertainty about whether lawyers and litigation funders are members of litigation funding schemes, but is not expected to have any substantive impact on existing business practices. The proposal further requires claimants to consent in writing to becoming members of the scheme and be bound by the terms of the scheme's constitution. This is consistent with requirements under the current legal framework surrounding active members of litigation funding agreements that constitute a MIS and further reinforces that funders cannot impose contractual obligations on plaintiffs who have not agreed to join the scheme.

As a result of this approach, funders may decide to undertake a book build to inform their decision to support a class action, by identifying, communicating with and enrolling class members in the action and getting them to sign a litigation funding agreement. The PJC has noted that this could lead to a greater level of investigation of the level of interest among class members. Book building can ensure that the merits and viability of a claim is assessed more thoroughly before a class action is commenced.

Multiple submissions received through the Government's consultation on the policy proposal in September 2021 argued for the retention of CFOs. Submitters argued that CFOs addressed the free-rider problem whilst also allowing the court to vary a funder's commission so that it is equitable. Both issues can be addressed through the proposed policy package. In particular, it remains open to funders to have recourse to other mechanisms developed by the courts such as FEOs.

Some stakeholders also highlighted the effect CFOs have on encouraging funders to initiate open class actions. The availability of CFOs may encourage multiple funders to seek to lodge competing class actions (even if this is ultimately settled through court processes to manage such a circumstance). Further, the availability of a CFO may mean that funders would not fully investigate

the merits of a class action before filing (notwithstanding the deterrent effect of adverse costs orders).

Arguments have also been made that CFOs magnify the size of claims and expected recoveries for litigation funders. As noted above, in the plurality in *Brewster* indicated that the equitable spreading of cost is better achieved through a FEO.

2. Clarifying court powers to approve or vary funding distribution methods

This element of the policy proposal is a variation of recommendation 11 of the PJC's report and recommendation 14 of the ALRC report. Each recommendation centres on enhancing judicial oversight of funder returns in line with the court's protective role in class action proceedings.

Both recommendations require court approval of litigation funding agreements for them to be enforceable and enable courts to alter, vary or amend the terms of an agreement. In making those recommendations, both the PJC and ALRC focused predominantly on the distribution of class action proceeds and the funders' contractual entitlement. However, the recommendations represent significant intervention in private contractual arrangements, as acknowledged by the ALRC. The ALRC also noted a stakeholder submission explaining such a recommendation would create uncertainty in litigation funding contracts.

To reduce such uncertainty, this proposal adopts a less interventionist approach to addressing the problem of windfall profitmaking by litigation funders at the expense of class members. It limits court approval and intervention in litigation funding agreements only to the extent its terms concern the method of distributing claim proceeds. This recognises and respects the right of parties to freely contract on the other important aspects of class action funding agreements which do not contribute to the policy problem identified by the PJC and ALRC.

Under this proposal, each funding agreement for a class action litigation funding scheme would have to be in writing and include the same 'claim proceeds distribution method' for distributing the proceeds to which scheme members are entitled under a judgment or settlement. The method would be focused on determining the share of these 'claim proceeds' that go to entities other than scheme members. The proposal requires any such entity to be a party to a funding agreement for the scheme. This approach captures any direct and indirect fee and commission mechanisms, including legal costs, and minimises risk of 'leakage' of claim proceeds through expenses which are not contemplated in the funding agreement.

Courts would be able to make orders to approve or vary the method to ensure it is fair and reasonable. The proposal would prevent distribution of any claim proceeds unless the court has made such orders to approve or vary the method. In making an assessment about the fairness and reasonableness of a proposed distribution method, courts would have to consider an exhaustive list of factors, including:

- the amount, or expected amount, of claim proceeds
- the funder's commercial return in comparison to the costs it incurred
- the legal costs incurred by or on behalf of scheme members and the reasonableness of those costs
- other costs incurred by the funder or other parties to a funding agreement, and the reasonableness of those

- whether the proceedings were managed in the best interests of scheme members to minimise the costs incurred by them or on their behalf
- the risks accepted by each party to a funding agreement.

Funders would be prevented from structuring their arrangements to avoid being subject to these provisions through an anti-avoidance provision, similar to those appearing elsewhere in the *Corporations Act 2001* (Corporations Act) and other Commonwealth legislation.

Benefits and costs

Class members

This option would give rise to a range of benefits to the members of a class action litigation funding scheme including:

- protection against windfall profit making and disproportionate returns to litigation funders identified by the ALRC and PJC
- assurance that they will receive a court-assessed fair and reasonable share of their claim proceeds in the proceeding
- greater certainty as to their returns in the relevant class action and how the court will make an assessment about the proportion of total claim proceeds under the scheme which will be used to compensate anyone who is not a scheme member.

Litigation funders

With respect to litigation funders, this element of the proposal:

- would prevent funders from extracting unfair returns from the claim proceeds received by members of a class action litigation funding scheme and so reduce instances of windfall profit making
- would provide greater certainty to funders about the court's power to intervene in a litigation funding agreement
- would provide clarity about how courts will assess a proposed distribution of class action proceeds between members and non- members of a class action litigation funding scheme
- may increase uncertainty to funders about their returns in a class action and the enforceability of their contracts, but this uncertainty is likely to abate over time as precedent is developed regarding fair and reasonable returns
- may reduce funding appetite, especially in situations where the funder may otherwise receive windfall profit
- may increase administrative costs to litigation funders to revise litigation funding agreements in compliance with the requirements regarding claim proceeds distribution methods.

The proposal also retains flexibility for existing practices and arrangements for third parties engaged to support the claimants' action. For example, if any such party is paid by the funder, only the funder (who is already by definition a member of the funding agreement) would need to be a party to the funding agreement if it seeks reimbursement against the claim proceeds for the scheme.

Community/environment

By regulating excessive profit making by third-party litigation funders and lawyers, contrary to the fundamental purpose of the class action regime, this proposal would enhance community confidence in the legal system.

This approach could also impact the broader community or environment by introducing uncertainty in the litigation funding market. This uncertainty could possibly arise from court powers being inconsistently exercised across cases or other unintended market responses to the change. In turn, this could reduce funding appetite and plaintiffs' ability to seek redress through the class action system.

However, if this risk manifests, it is likely to be temporary, as the market adjusts to the additional regulation. For example, the uncertainty caused by inconsistent judicial decisions is likely to diminish as case law regarding the provisions evolves. Similarly, a reduction in the funding activity of existing litigation funders may prompt the entry of new funders and is not inappropriate when caused by an inability to make windfall profits.

Relevantly, the ALRC referred to a submission by Maurice Blackburn which acknowledged a discrete statutory power to vary, amend or reject litigation funding agreements 'may introduce a degree of uncertainty and timidity in the litigation funding market'. However, it noted Maurice Blackburn's suggestion the impact would be temporary, as the 'practical application of this type of provision evolves and principles become settled.'

Government

This element of the proposal would create a statutory power for any court exercising federal jurisdiction to approve a litigation funding agreement. It also:

- would enhance court oversight over litigation funders and funding agreements
- would clarify and settle conflicting case law on the power of the court to intervene in litigation funding agreements
- would promote appropriate use of judicial resources in assessing the claim proceeds distribution method by providing relevant factors for consideration
- would address judicial calls for guidance on assessing litigation funding agreements in *Liverpool City Council v McGraw-Hill Financial, Inc (now known as S & P Global Inc)* [2018] FCA 1289
- would enhance the court's protective jurisdiction in class action proceedings, especially when combined with the proposal to require members of a class action litigation funding scheme to provide written consent to enter the scheme
- may prevent the court from considering other factors in determining a fair and reasonable distribution of class action proceeds between a funder and members of a class action litigation funding scheme
- may increase the time and resources expended by the court on approving settlements and awarding judgments in a class action.

Reasons for recommending this proposal

This proposal presents a flexible, fit-for-purpose approach to regulating windfall returns to funders in the class action litigation funding industry. In particular, the approach:

- recognises the need for courts to be able to adjust the distribution of class action returns for the circumstances of a particular case
- ensures fair and reasonable returns to class members within existing frameworks of the court's protective jurisdiction towards class members
- minimises interference in private contractual relationships between funders and plaintiffs.

This proposal reflects submissions to the ALRC inquiry and feedback from the Government's two consultations. The ALRC noted the majority of stakeholders who submitted to its inquiry favoured a statutory basis for the court's power to reject, vary or set the commission rate in litigation funding agreements. However, in arriving at recommendation 14, the ALRC agreed with the Australian Bar Association that the commission rate was not the only 'contractual integer' that determined the funder's contractual entitlement, and that the Court's power to reject or vary the funding agreement should be extended to other terms relevant to the calculation of the funder's entitlement to payments.

In feedback to the Government's June 2021 consultation, stakeholders from across the class action industry expressed support for a Federal Court power to approve, reject, vary and amend the terms of litigation funding agreements as recommended by the PJC and ALRC rather than an inflexible guaranteed minimum return to class members. This included industry groups, law firms and legal associations, and litigation funders.

Stakeholder feedback on the specific court approval mechanism in the policy proposal was mixed. Some stakeholders, including litigation funders and class action law firms, objected to the requirement for court approval and intervention, the 'fair and reasonable' test and exhaustive factors for court consideration in determining whether a proposed distribution method is fair and reasonable. Other stakeholders, including some funders and class action law firms, supported legislative reform to enable courts to approve or vary the claims proceeds distribution method. Business stakeholders also favoured reform to provide guidance to the court in evaluating a claim proceeds distribution method.

On balance, the Government considered the proposal strikes an appropriate balance between maintaining flexibility in individual cases while ensuring a fair and reasonable distribution of class action proceeds.

3. Introducing a rebuttable presumption about the distribution of claim proceeds to cover costs

This element of the proposal was not included in the PJC or ALRC reports. However, recommendation 20 of the PJC report contemplated a form of direct price regulation to address identified 'systemic and inappropriate skewing of the proceeds of a successful class action in favour of litigation funders at the expense of class members'.

This element is intended to supplement the element discussed at section •2 above. It is operationalised when a court considers whether a proposed claim proceeds distribution method is fair and reasonable. In these cases, the court would be guided by a rebuttable presumption that a

distribution of over 30 per cent (in aggregate) of the claim proceeds to entities who are not scheme members is not fair and reasonable.

This approach is less interventionist than a fixed cap on returns as contemplated by recommendation 20 of the PJC report. It signals the Government's policy objective that plaintiffs in a class action should receive a fair and reasonable return but maintains flexibility for the court to adjust the distribution of class action proceeds to reflect the circumstances of the case. This flexibility also addresses the inability of a fixed cap approach to eliminate windfall profits in cases with very high judgment awards or settlement amounts, and the potential impact of such an approach on funding of smaller or more complex matters.

Benefits and costs

Class members

This element would give rise to a range of benefits to the members of a class action litigation funding scheme including:

- protection against windfall profit making and disproportionate returns to litigation funders identified by the ALRC and PJC
- assurance that they will receive a court-assessed fair and reasonable share of their claim proceeds in the proceeding.

Under a fixed cap approach to returns, the cap may also become a floor if it incentivises funders and lawyers to charge costs of 30 per cent of the claim proceeds, even when a lower portion is warranted. This is less likely to occur with a rebuttable presumption approach. Further, the risk is mitigated by the proposed court power to adjust the claim proceeds distribution method after considering factors such as the funder's return on its actual costs (as discussed in section •2 above) to ensure a fair and reasonable distribution to the scheme's members.

Litigation funders

With respect to litigation funders, this element of the proposal:

- would prevent funders from extracting unfair returns from the scheme proceeds and so reduce instances of windfall profit making
- may increase uncertainty to funders about their expected returns in a class action, but this uncertainty is likely to abate over time as a body of precedent is developed
- may reduce funding appetite until the increased uncertainty is abated, particularly for matters where the likely cost of proceedings is large relative to the likely proceeds
- may incentivise funders to adopt strategies on cases to ensure a minimum commercial return within the confines of the regime, which may not be in class members' best interests (although this risk is mitigated by the court's power to review the fairness and reasonableness of the proposed distribution of claim proceeds to non-members)
- may increase compliance costs as funders change their behaviour and arrangements to comply with the new regime.

Community/ environment

The impact of this element on the community and environment is as discussed in section •2 above. It would also promote greater certainty in the market about the distribution of proceeds in class actions.

In addition to these factors, some stakeholders responding to the Government's September 2021 consultation on the policy proposal suggested a rebuttable presumption could encourage strategic responses by defendants to 'run up' the costs of a proceeding by engineering delays and commencing unnecessary interlocutory processes. Finally, some stakeholders noted these and other practices could make settlement of class actions more difficult to achieve.

These risks would be mitigated by the flexibility available to the court to find the presumption has been rebutted, including by reference to the complexity and duration of the proceedings and the reasonable legal costs incurred by or on behalf of scheme members.

Government

This element of the proposal would:

- provide guidance to the court as it exercises its powers to approve or vary the claim proceeds distribution method in funding agreements
- promote appropriate use of judicial resources in assessing the claim proceeds distribution method
- reduce time and resources expended by the court on approving settlements and awarding judgments in a class action once a body of case law has developed around the new regime
- provide clarity about the Government's policy position that class action plaintiffs should receive a fair and reasonable return of class action proceeds.

Reasons for recommending this proposal

The PJC's report favoured a mechanism to regulate litigation funding commissions to address systemic and inappropriate profits by litigation funders at the expense of class members. Of the options considered by the PJC and Government, this proposal presents the most flexible approach. It promotes certainty and provides guidance on the Government's expectation of fair and reasonable returns to class members, while recognising the critical role of the courts in tailoring the distribution of claim proceeds in individual cases.

The recommended approach reflects submissions to the PJC inquiry and feedback from the Government's two consultations. The PJC considered a range of options to address this concern. Among its recommendations was recommendation 20 to consult on various design elements of a guaranteed statutory minimum return of gross class action proceeds to class members including a proposed minimum return of 70 per cent.

The Government undertook consultation in line with recommendation 20 in June 2021. Most stakeholders opposed a guaranteed statutory minimum return to class members. Further, of those stakeholders who supported a minimum return, most favoured appropriate flexibility to amend the minimum return in particular cases or as part of a graduated approach overseen by courts. Several stakeholders suggested a rebuttable presumption (or a statutory minimum return which could be amended) which would enable courts to find the presumption had been rebutted where justified.

In response to this feedback, the Government consulted on a specific design of an alternative option in September 2021, being a rebuttable presumption that a return to the members of a class action litigation funding scheme of less than 70 per cent of their gross proceeds in the proceeding is not fair and reasonable. Some stakeholders considered the design created uncertainty about whether the method captured the distribution of proceeds among members of the scheme (rather than between members as a whole and litigation funders). Accordingly, the Government refined the design of the

presumption to frame it in terms of the overall proportion of claim proceeds which would be distributed outside the scheme's membership. This design promotes greater certainty by ensuring all relevant costs are captured by the presumption.

4. Requiring consideration of fee assessor and contradictor advice and payment of costs

The proposed reform varies PJC recommendations 13 and 18, by mandating that where the court has referred the funding agreement to a litigation fee assessor for inquiry into the funder's remuneration, the court must receive and consider the assessor's report in deciding to approve or vary the claim proceeds distribution method unless it is not in the interests of justice. Ordinarily, a court would already consider the report of a referee or contradictor where one has been assigned. For example, section 54A of the *Federal Court Act* 1976 states that the Federal Court may deal with reports as it thinks fit, including adopting, varying, rejecting the report or making such orders as the court sees fit.

Similarly, the proposed reform mandates that where the court has appointed a contradictor to represent the scheme's members, the court must consider the contradictor's representations in deciding to approve or vary the claim proceeds distribution method unless it is not in the interests of justice to do so. As above, considering the views of a contradictor where one is appointed would ordinarily already occur within the courts.¹

This proposal also varies the implementation of PJC recommendations 16 and 18 to require the constitution of a class action litigation funding scheme to provide that under each funding agreement, litigation funders are to cover all reasonable costs of a referee or contradictor appointed by the court, unless the court orders otherwise. Conversely, recommendations 16 and 18 are that the litigation funder be required to meet these costs in circumstances where the conduct of the funder justifies such an order being made.

Reasons for recommending this proposal

These reforms make it clear that a court must turn its mind to referee reports and the representations of contradictors in assessing the claim proceeds distribution method. This ensures that courts consider the appropriate information in determining whether to approve or vary the distribution of claim proceeds in a litigation funding agreement.

However, while these reforms go beyond, and are more prescriptive than the PJC recommendations, they retain court discretion if considering the contradictor's representations or the referee's report is not in the interests of justice. Retaining court discretion in appointing a contradictor or referee but mandating the court consider any report provided was supported by a number of submissions received during the Government's consultation in September 2021.

The reforms also make clear that the funder is responsible for, and cannot pass on, the costs of referees and contradictors. The implementation of this approach differs slightly from the PJC recommendations but aligns with the principle that the funder should bear responsibility for any processes that assist the court to determine that their proposed distribution of the claim proceeds of a class action litigation funding scheme is fair and reasonable. This is consistent with the

¹ Parliamentary Joint Committee on Corporations and Financial Services, *Litigation Funding and the regulation of the class action industry*, Final Report, December 2020, Chapter 12 Parliamentary Joint Committee on Corporations and Financial Services, *Litigation Funding and the regulation of the class action industry*, Final Report, December 2020, Chapter 12.

Government's key objective of protecting the interests of the class members and ensuring a fair and reasonable distribution of the claim proceeds of a class action litigation funding scheme.

This proposal additionally does not mark a significant departure from the status quo that litigation funders would ordinarily cover the costs of a referee or contradictor as part of their commitment to cover the costs of litigation.

During the Government's consultation on the policy proposal in September 2021, stakeholders raised that mandating litigation funders pay the costs of any fee assessor and contradictor would result in these costs being passed on to group members. The proposed policy package provides protection against this scenario by:

- ensuring the court retains discretion in appointing a referee or contradictor
- establishing the rebuttable presumption considered at section 3 above
- including a provision so that a funder is barred from recovering these costs from the claim proceeds of the class action litigation funding scheme.

5. Extending the jurisdictional impact of some recommendations

Several reforms in this proposal go beyond PJC recommendations 7, 11, 12, 13, 16, 18 and ALRC recommendation 14 in that they extend the application of the recommended reform beyond the Federal Court to all state and territory courts exercising federal or state/territory jurisdiction. This element of the proposal seeks to maximise protection for class members across Australia. The reform package adopts an expansive approach seeking to extend regulation to litigation funding agreements for class actions in any Australian court.

This avoids the risk of 'forum shopping' by funders filing in courts which do not have the same level of protection for class members. This implementation approach also achieves national consistency across class action regimes, something multiple stakeholders have argued for and a key recommendation of the PJC (see recommendation 31).

6. Addressing conflicts of interest involving plaintiffs' lawyers and funders

This element of the proposal represents an extension of recommendation 26 of the PJC report and recommendation 21 of the ALRC report. In considering the circumstances arising in the class action against Banksia Securities Limited (Banksia) brought on behalf of Banksia debenture holders, the ALRC and PJC each recommended amending legal profession conduct rules to prohibit certain legal representatives from having a financial or other interest in a third-party litigation funder that is funding the same matter on which they are acting.

Neither the PJC nor the ALRC recommended corresponding prohibitions on third-party litigation funders in respect of the same conduct. This element of the policy proposal addresses this inconsistency by proposing an amendment to the Corporations Regulations 2001 (Corporations Regulations) to impose prohibitions and sanctions on funders. Under this approach, as a condition of the litigation funder's Australian Financial Services Licence (AFSL):

- the funder must maintain adequate practices for ensuring lawyers providing services in relation to a class action litigation funding scheme do not have a material financial interest in the funder
- the lawyers cannot have or obtain a material financial interest in the funder

- if a lawyer providing services in relation to the scheme does have or obtains a material financial interest in the funder, the funder must ensure the lawyer stops providing the services or relinquishes the interest.

If a funder breached this condition of licence, the Australian Securities and Investments Commission (ASIC) could suspend or cancel their licence, preventing them from offering litigation funding services.

This proposal would also extend protection to plaintiffs of funding regimes that are exempt from the MIS and AFSL regimes, including insolvency litigation funding schemes and litigation funding arrangements. Funders for these regimes would be required to maintain adequate practices for managing conflicts of interest and ensuring lawyers providing services in relation to the exempt regime do not have or obtain a material financial interest in the funder.

The amendments also recognise that the material financial interests may be held by close associates of the lawyer.

Benefits and costs

Class members

This proposal would give class action plaintiffs stronger protection against conflicts involving financial interests between plaintiffs' legal representatives and funders, who have significant control over the carriage of their class action.

It could give rise to potential disruption or delay in some cases if it is necessary to find new solicitors, counsel or funders in compliance with the provision. However, the probability of this risk is very low, as case law already indicates court opposition to lawyers having a financial interest in a case on which the lawyer is engaged. Accordingly, it is likely lawyers are already conscious of the need to separate their financial interests from the funder in any given case as is appropriate. Further, the benefits of addressing identified non-compliance and misconduct outweighs the harm to a litigant associated with any temporary delay to instruct new, non-conflicted legal representatives.

Members in other funded proceedings

This proposal would give plaintiffs in proceedings involving insolvency litigation funding schemes and litigation funding arrangements stronger protection against conflicts of interest involving financial interests between their legal representatives and funders.

Litigation funders and legal representatives

This proposal would have the following impacts on litigation funders and legal representatives:

- loss of income from financial interests which were relinquished under the regulation
- increased compliance costs, including for establishing practices to prevent the conduct covered by the regulation.

However, in light of the Supreme Court of Victoria's clear decision that the circumstances in the Banksia class action gave rise to an unacceptable conflict of interest, it is likely that most law firms, legal practitioners and barristers have already divested any financial interests (if any) or recused themselves from cases which would be captured by this proposal. Accordingly, funders are likely already complying with this proposal.

Further, under section 912A of the Corporations Act, litigation funders are already required to have in place adequate conflict management arrangements. This requirement also applies to exempt litigation funding regimes under paragraph 7.6.01AB(2)(a) of the Corporations Regulations.

Accordingly, this element of the proposal is likely to have minimal or no additional regulatory impact on funders and legal representatives. Rather, its effect would be to assist in the prevention of future misconduct of this nature.

Community/environment

This option would promote greater confidence in the legal system in the community by establishing regulatory consistency between lawyers and funders in respect of the same conduct.

Government

With respect to the impact on Government, this option:

- increases the oversight and enforcement tools available to ASIC to regulate conflicts of interest of the kind arising in the Banksia class action
- may increase the time and resources required by ASIC to oversee and enforce the relevant regulations.

Reasons for recommending this proposal

This proposal supplements the PJC and ALRC recommendations, which, in isolation, would not prohibit funders funding actions with conflicted legal representatives, despite the close relationship between the funder and the legal representative and the duties they each owe to their common clients.

It also creates regulatory consistency in addressing the policy problem, which would account for any gaps arising from implementation of the PJC and ALRC recommendations alone, without corresponding regulation of litigation funders in respect of the same conduct.

Further, unlike the PJC and ALRC recommendations, this approach does not rely on professional self-regulation to address the wrongdoing identified in the Banksia case and provides greater assurance to parties that their funders are acting in their best interests and are subject to appropriate ASIC oversight. It also provides a mechanism for timely response to the policy problem in the event the professional legal bodies are delayed in implementing the recommendation.

As noted above, this proposal is not likely to increase the regulatory burden on litigation funders and legal representatives but will protect parties to funded proceedings against future misconduct.

The PJC noted some stakeholders considered the alleged issues and misconduct arising in the Banksia case warranted regulation of litigation funders under financial services regulation, which contributed to the PJC's recommendation of a fit-for-purpose MIS regime for litigation funders. There was also support for the proposed measure in the Government's September 2021 consultation.

Evaluation and implementation

The policy proposal will be implemented through legislative changes to the Corporations Act and the Corporations Regulations. If the legislation is passed and the reforms commence, the new processes would be subject to ongoing monitoring to ensure they operate effectively. Treasury and the Attorney-General's Department will consider options, including post implementation review,

following the commencement of the new processes. The Government will continue to engage with stakeholders to determine the effectiveness of the reforms.

Regulatory burden estimate

This regulatory burden estimate covers the policy settings for the proposed reforms set out in the policy proposal, including the elements in sections 1 to 7 listed above, to the extent the expected impacts of the proposal fall within the Regulatory Burden Measurement framework.

It is estimated the regulatory cost of this proposal is on average between \$68,000 and \$95,000 per year (over 10 years), as set out in the table below. Elements of the proposal which have not been discussed in this section were assessed to have a nil regulatory impact for the purposes of the Regulatory Burden Measurement framework.

Average annual regulatory costs (from business as usual)				
Change in costs	Business	Community Organisations	Individuals	Total change in cost
Total, by sector	\$68,000 to \$95,000	Nil	Nil	\$68,000 to \$95,000

The following assumptions were adopted in developing the regulatory burden estimate associated with the policy proposal:

- Number of class action litigation funding schemes each year:** It is assumed every third-party funded class action filed after the start of the new regulations would involve a class action litigation funding scheme. It was estimated 32 class actions involving third-party litigation funding would be filed each year of the 10 year regulatory burden estimate. This was based on an average of the number of filed class actions involving a litigation funder between 2017/18 and 2020/21 as reported in *2020/21 Review of Class Actions* by King & Wood Mallesons, released on 22 September 2021 (KWM Report).
- Number of litigation funders operating in Australia:** It is assumed 33 litigation funders will operate in Australia for each year of the regulatory burden estimate. This is based on the number of funders listed in the ALRC report,² which was subsequently referenced by the PJC.³
- Time taken to amend the constitution and funding agreements to comply with the claim proceeds distribution method requirements:** To calculate the regulatory burden estimate associated with these proposed new requirements, it was necessary to estimate the time it would take to implement the requirements. The value of this time was calculated using guidance provided by the Office of Best Practice Regulation of the standard hourly wage rate for a business.⁴

 - It was assumed each funding agreement was already in writing and contained a claim proceeds distribution model.

² Australian Law Reform Commission, *Integrity, Fairness and Efficiency – An Inquiry into Class Actions Proceedings and Third-Party Litigation Funders*, Final Report, December 2018, pp. 65, 81.

³ Parliamentary Joint Committee on Corporations and Financial Services, *Litigation Funding and the regulation of the class action industry*, Final Report, December 2020, p. 35.

⁴ Australian Government, Department of the Prime Minister and Cabinet, Office of the Best Practice Regulation, *Regulatory Burden Measurement Framework Guidance Note*, March 2020, p. 11.

- It was recognised that litigation funders would likely have to undertake further work to adjust to the reforms and arrange for the relevant amendments to be made to each scheme constitution and funding agreement. This could include a range of activities such as assessing the implications of the changes, drafting new constitutional provisions, aligning the claim proceeds distribution across the funding agreements associated with a class action litigation funding scheme, developing guidance and disclosure for scheme members, liaising with regulators, seeking legal advice and obtaining approval from scheme members.
- It was assumed that once the requirement had been embedded, less work would be required for each scheme.
- **Impact on courts to operationalise powers to approve and vary the claim proceeds distribution method and rebuttable presumption:** The elements of the proposal outlined at sections •2 and 3 may have a regulatory impact on the administration of courts and tribunals in federal and state jurisdictions.
 - As noted in sections •2 and 3 above, some elements of the proposal are likely to increase regulatory costs on courts and tribunals while others are likely to provide regulatory efficiencies.
 - These impacts have not been quantified for the purposes of this regulatory burden estimate, as there is no typical, uniform, practicable or reliable measure to determine the time spent by the court in making the assessments required under the proposed reforms, or valuing the time spent in doing so. The circumstances of each case, including its complexity, makes any estimation of the court’s time on it highly speculative.
 - Further, a significant portion of the value of the court’s time in complying with the policy proposal is inextricably linked to the opportunity cost of those court resources not being allocated to other matters. Opportunity costs are excluded from the Regulatory Burden Measurement framework.
- **Time taken to adjust financial models in compliance with the rebuttable presumption:** It is assumed that litigation funders will experience a regulatory burden to assess and reevaluate financial models and business operations in the first year of the reforms.
 - The financial models are likely to rely on commercially sensitive, non-public information, including the funder’s risk appetite and target return on invested capital. Further, stakeholder submissions have indicated litigation funders approach the funding of cases on a portfolio basis.
 - In these circumstances, and with the limited data available, it is not practicable to estimate how much time and other compliance costs would be required to adjust commercial models to accommodate the rebuttable presumption. Accordingly, no estimate has been made with respect to this element of the proposal.
- **Time taken to seek to test the rebuttable presumption:** It is assumed that in the first year of the proposed reforms, parties in some funded cases will seek to test the rebuttable presumption with the court, and therefore spend time over and above the time spent on the ordinary conduct of the case, to develop submissions in favour of overturning the presumption.

- Analysis commissioned by Omni Bridgeway in its submission to the Government’s June 2021 consultation indicated that with a 30 per cent cap on all costs of a funded proceeding, 36 per cent of funded cases would not proceed as the cap would not fully cover the legal costs alone.⁵ It is assumed that under the proposed rebuttable presumption, the funder would seek to rebut the presumption in these cases.
- It is further assumed the regulatory cost of seeking to rebut the presumption will diminish over time, as a body of case law develops and principles are established for when the presumption will be rebutted. As such, the presumption will be tested in fewer cases over time.
- However, there is no consistent, reliable method for determining the time it would take to prepare for, and ultimately make submissions to rebut the presumption in any given case. This would rely heavily on the proceedings, any relevant precedent on which the court may rely, and the unique circumstances of the case. Accordingly, no costing has been provided for this measure.
- **Time taken to comply with the conflicts of interest provision:** As discussed in section •6 above, it is assumed normally efficient litigation funders and lawyers are already managing conflicts of the type contemplated by the policy proposal as part of their normal business practice, particularly given the recent decisions in the Banksia class action and the requirements in section 912A of the Corporations Act and paragraph 7.6.01AB(2)(a) of the Corporations Regulations. Accordingly, it is assumed there is no additional regulatory impact associated with this measure. Further, any such burden would be excluded from the calculation of regulatory burden pursuant to the Regulatory Burden Measurement framework.

⁵ PwC, *Models for the regulation of returns to litigation funders*, March 2021, p. 16.

Appendix

PJC recommendations

- **Recommendation 7:** the Australian Government legislate to address uncertainty in relation to common fund orders, in accordance with the High Court's decision in *BMW Australia Ltd v Brewster; Westpac Banking Corporation v Lenthall* [2019] HCA 45
- **Recommendation 11:** Part IVA of the *Federal Court of Australia Act 1976* be amended to introduce:
 - a requirement for a litigation funding agreement to obtain approval of the Federal Court of Australia to be enforceable; and
 - a power for the Federal Court of Australia to reject, vary or amend the terms of any litigation funding agreement when the interests of justice require.
- **Recommendation 12:** Part IVA of the *Federal Court of Australia Act 1976* be amended to require that any litigation funding agreement in a class action in the Federal Court of Australia is governed by Australian law and the Federal Court of Australia approves a litigation funding agreement only if the agreement provides that the litigation funder submit irrevocably to the jurisdiction of the Federal Court of Australia.
- **Recommendation 13:** the Australian Government amend the Federal Court of Australia's Class Actions Practice Note to the effect that, pursuant to section 54A of the *Federal Court of Australia Act 1976*, at any point in a proceeding, the Federal Court of Australia may appoint a referee to act as a litigation funding fees assessor.
- **Recommendation 16:** the Federal Court of Australia's Class Actions Practice Note state the Federal Court of Australia may order the costs of the work undertaken by a referee appointed by the Federal Court of Australia as a litigation funding fees assessor be paid by a litigation funder, in circumstances where the conduct of a litigation funder justifies such an order being made.
- **Recommendation 18 (partial):** the Federal Court of Australia's Class Actions Practice Note be amended to:
 - introduce a presumption that the Federal Court of Australia is to appoint a contradictor in instances where there is the potential for significant conflicts of interest to arise, or complex issues are likely to arise at the settlement approval application;
 - ensure the Federal Court of Australia may order the costs arising from the work undertaken by a contradictor be paid by the plaintiff law firm, or the litigation funder, in circumstances where the conduct on the part of the lawyer or the litigation funder justifies such an order being made.
- **Recommendation 20:** the Australian Government consult on:
 - the best way to guarantee a statutory minimum return of the gross proceeds of a class action (including settlements);
 - whether a minimum gross return of 70 per cent to class members, as endorsed by some class action law firms and litigation funders, is the most appropriate floor; and

- whether a graduated approach taking into consideration the risk, complexity, length and likely proceeds of the case is appropriate to ensure even higher returns are guaranteed for class members in more straightforward cases.

ALRC recommendations

- **Recommendation 3:** Part IVA of the *Federal Court of Australia Act 1976 (Cth)* should be amended to provide the Court with an express statutory power to make common fund orders on the application of the plaintiff or the Court's own motion
- **Recommendation 14:** Part IVA of the *Federal Court of Australia Act 1976 (Cth)* should be amended to provide that:
 - third-party litigation funding agreements with respect to representative proceedings are enforceable only with the approval of the Court;
 - the Court has an express statutory power to reject, vary, or amend the terms of such third-party litigation funding agreements;
 - third-party litigation funding agreements with respect to representative proceedings must provide expressly for a complete indemnity in favour of the representative plaintiff against an adverse costs order; and
 - Australian law governs any such third-party litigation funding agreement the funder submits irrevocably to the jurisdiction of the Court.
- **Recommendation 21:** The Australian Solicitors' Conduct Rules should be amended to prohibit solicitors and law firms from having financial and other interests in a third-party litigation funder that is funding the same matter in which the solicitor or law firm is acting.