PARLIAMENTARY JOINT COMMITTEE ON CORPORATIONS AND FINANCIAL SERVICES

PUBLIC SUBMISSION
LITIGATION CAPITAL MANAGEMENT LIMITED
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PART A: INTRODUCTION

Litigation Capital Management Limited

1. Litigation Capital Management Limited and its subsidiaries ("LCM") is a provider of litigation finance products, and from that perspective makes the below submission on matters related to the Terms of Reference of the Parliamentary Joint Committee on Corporations and Financial Services Inquiry into "Litigation Funding and the Regulation of the Class Action Industry".

2. Founded in 1998, LCM was one of the first professional litigation funders in Australia, and it is one of the oldest litigation funders globally. LCM is publicly listed and headquartered in Sydney. LCM also has offices in Melbourne, Brisbane, Singapore and London. Further information about LCM can be found on www.lcmfinance.com.

3. Since its inception, LCM has continued to assist claimants to pursue meritorious claims and recover funds from the legal avenues and actions available to them.

4. LCM funds commercial, insolvency and arbitral proceedings, as well as representative actions. LCM has a particular focus on corporate portfolio funding, being the provision of non-recourse finance facilities to corporate clients.

Funding corporate Australia

5. LCM notes that the Terms of Reference are limited to the "class action industry" and it is in this context that LCM provides the below submission. However, LCM stresses that litigation funding is not only used in class actions, but is commonly utilised by insolvency professionals and is increasingly employed as a finance solution by corporate Australia.

6. LCM's corporate litigation finance products provide businesses with access to capital while only securing that finance against the company's legal claims (rather than any of its operating assets). This solution offers flexible finance, improves cash flow, results in increased retention of company funds for core business activities (increasing revenue) and increases profit margins, without any added encumbrance on key business assets.

7. It is obvious that an additional source of non-recourse capital can strengthen Australian businesses and stimulate economic growth. LCM submits that this is never more accurate or important than in times of recession.

8. Consequently, LCM submits that any regulatory change aimed at curtailing the funding of class actions must be carefully and deliberately formulated so as not to restrict the broader financial assistance that reputable funders provide in other aspects of our business.

9. By way of a current example of such assistance, LCM directs attention to an announcement made by the ASX listed Indiana Resources Limited on 2 June[1], wherein

[1] https://indianaresources.com.au/wp-content/uploads/2020/06/200602_US4.65-million-Litigation-Funding_Final.pdf

the company reported on a funding agreement with LCM that will see it receiving USD$4.6million in support.

10. The company's Chairman stated:

"I am incredibly pleased that we have secured a litigation funding agreement with LCM that can cover legal costs in bringing our Claim… The fact that we now have a funding solution where litigation is funded by an experienced and dedicated party and costs will not be borne by Indiana's shareholders is a concrete step in preparing for arbitration to commence as soon as possible. LCM is one of the world's most reputable litigation finance companies and its willingness to support our claim is a tremendous vote of confidence. The agreement with LCM clearly demonstrates that we are sharing the risk and reward with a litigation funding partner and that makes solid commercial sense for the Company."

PART B: EXECUTIVE SUMMARY

Regulation of litigation funders (Part C, page 6)

LCM is one of the oldest Australian litigation funders, is publicly listed and holds an Australian Financial Services Licence ("AFSL"). LCM presently believes it is the only funder to be licensed in Australia.

LCM supports relevant regulation of litigation funders but submits that in order to achieve its policy objectives the regulatory regime should be tailored to the industry.

LCM submits that any regulatory change must exclude class actions filed before 22 August 2020.

Australian Financial Services Licence

LCM supports the introduction of licensing and further submits that the AFS licensing regime for litigation funding should consider the following bespoke features:

- A *licence "in kind"* that applies to the provision of all litigation funding services by the licensed entity, rather than requiring a funder to apply for a separate licence for each individual funding project.

- *Greater transparency*, including a requirement for all funders to regularly lodge publicly available audited financial statements.

- *Organisational resources / capital adequacy* to ensure funders have adequate capital to meet their commitments. LCM supports a net tangible asset requirement of $5million per licenced entity.

- *Competence* of responsible managers, ensuring they have the skills and expertise to effectively provide litigation financing services with reference to legal and insolvency education, understanding of solicitors' obligations and the requirements of the bespoke AFSL.

- *Wholesale licence* to apply a relevant level of regulatory oversight and reflect that litigation funding is commonly used by insolvency practitioners and increasingly as a business finance solution by Australian businesses.

Managed investment scheme regime

LCM advocates against application of an incongruent managed investment scheme regulatory regime without significant legislative adaptation. The regime is not presently compatible with the Courts' class action system nor with litigation funding products. If implemented "as is", the regime would have dramatic long-term consequences for class members.

Funder commissions in class action (Part D, page 15)

Evidence confirms that the existing regime sees class members receiving the bulk of settlement proceeds. In the absence of the availability of funding, class member returns would be significantly reduced.

LCM advocates against pre-determined outcomes, such as fixed minimum returns for class members. Such measures fetter Court discretion and restrict contractual freedom of market participants. Introduction of such restrictions will have a negative long term effect on the fair and equitable outcomes for class members.

If such measures were to be introduced, LCM submits that predetermined percentages can only be fixed by reference to the net returns achieved in the claim after the deduction of costs, rather than by reference to gross recovery.

Contingency fees (Part E, page 20)

As a litigation funder LCM does not take a view on whether solicitors ought to be able to enter contingency fee agreements. However, LCM does note that litigation funders do not control class action proceedings, and that contingency fee arrangements may carry an inherent risk of a conflict of interest. LCM also submits that such arrangements may not increase long term returns to class members.

Class actions and the economy (Part F, page 23)

Litigation finance is an important tool for companies seeking to preserve capital within business operations. Rather than seek to fund claims against “vulnerable” businesses, LCM is assisting such companies through the provision of non-recourse finance secured only against their legal claims.

LCM recognises the importance of Australia’s continuous disclosure rules in engendering trust in markets and encouraging investment. LCM suggests that a permanent relaxation of these rules may have consequences contrary to shareholders interests, the viability of securities markets and the availability of capital. In making this submission, LCM notes that pure continuous disclosure claims are not, and never have been, a focus of LCM’s business.

Common fund orders (Part G, page 25)

While acknowledging that the announced application of the managed investment scheme regime to class actions may render common fund orders an impossibility, LCM submits that common fund orders would improve fair and equitable outcomes for both plaintiffs and defendants by ensuring every claim is litigated only once and the costs of litigation are borne evenly by each person who benefits from its resolution.

PART C: REGULATION OF LITIGATION FUNDERS

Whether the present level of regulation applying to Australia's growing class action industry is impacting fair and equitable outcomes for plaintiffs, with particular reference to the following:

Item 5: The Australian financial services regulatory regime and its application to litigation funding

Item 6: The regulation and oversight of the litigation funding industry and litigation funding agreements

Item 10: The effect of unilateral legislative and regulatory changes to class action procedure and litigation funding

- **LCM is publicly listed and holds an Australian Financial Services Licence**
- **LCM supports relevant licensing of litigation funders**
- **LCM advocates against application of incongruent managed investment scheme regime without adaptation**
- **Any regulatory change must exclude class action proceedings already on foot**

11. LCM supports increased regulation of the litigation funding industry and has long championed the introduction of a relevant licensing regime as an added means of ensuring continued integrity within the industry.

12. LCM not only talks of increased oversight and transparency, but actively complies with a higher level of regulation than most of its peers:

    12.1. As a publicly listed company, LCM is subject to market regulation, including financial reporting and continuous disclosure requirements;

    12.2. LCM holds an Australian Financial Services Licence[2] (and presently believes it is the only funder to be licenced in Australia); and

    12.3. LCM's key staff are officers of the Court. The Chief Executive Officer of LCM (Patrick Moloney) is a solicitor admitted to the Supreme Court of New South Wales, and all of LCM's Australian Investment Managers are admitted legal practitioners that hold current practising certificates.

13. With the benefit of its experience as a pioneer of the litigation funding industry, LCM provides the below comments on requirements that, in LCM's submission, ought to be present in any effective and relevant licensing regime for litigation funders.

14. LCM also comments on the recent announcement of the Honourable Josh Frydenberg MP that from 22 August 2020 all litigation funders will be required to hold an Australian

[2] Australian Financial Services Licence No 343496

Financial Services Licence ("AFSL") and to comply with the managed investment scheme ("MIS") regime.

AFSL and submission in favour of effective and relevant licensing

15. As noted above, LCM supports the move to licensing of litigation funders, and further notes and accepts that such licensing will be introduced through the AFSL framework.

16. In announcing the introduction of the AFSL requirement, the Treasurer advised that AFSL compliance will ensure "greater transparency" and that funders will be required to:

    16.1. Act honestly, efficiently and fairly;

    16.2. Maintain an appropriate level of competence to provide financial services; and

    16.3. Have adequate organisational resources to provide the financial services covered by the licence.

17. LCM submits that in order to ensure that the licensing regime meets these objectives for litigation funding products and does not impose measures that are counter-productive to the efficient and fair provision of funding services, the AFSL for litigation finance must be tailored to its industry. In the absence of such tailoring, LCM submits that broad licensing will misfire with regard to some unique but significant features of litigation finance.

18. LCM submits that the AFSL required for the provision of litigation funding products ("AFSL (Dispute Finance)") should have the following bespoke features:

    18.1. <u>A licence "in kind":</u>

    Each AFSL (Dispute Finance) should authorise the provision of all litigation funding services by the licensed entity. A funder should not be required to apply for a separate licence for each individual funding project, as this approach would cause unnecessary delays and, in extreme cases, could lead to the expiry of meritorious claims.

    18.2. <u>Transparency:</u>

    The AFSL (Dispute Finance) should be tailored to require all funders to regularly lodge publicly available audited financial statements.

    Clients contracting with a litigation funder ought to have a clear line of sight to the resources that a funder holds to meet its commitments.

    In the context of class actions, defendants should also have visibility into the resources that a funder holds to meet a prospective adverse costs order.

    18.3. <u>Organisational resources / capital adequacy / net tangible assets:</u>

    Although LCM notes that Court rules on security for costs presently provide protection to both defendants and, indirectly, to plaintiffs, LCM suggests that it is critical for funders to have access to sufficient capital to meet their commitments.

LCM submits that the AFSL (Dispute Finance) should be tailored to require each licence holder to have ongoing access to a minimum of $5million in assets in Australia.

LCM advocates against the introduction of "per project" capital requirements, as this does not recognise the exponentially decreasing risk of loss that occurs in a larger book of claims. Put another way, a larger book of claims probably means that the funder has committed more future capital. But it also means that the funder has more forecast income and, importantly, an increased hedging of risk across all of its funded claims. In addition, a "per project" capital requirement would likely make it uneconomic to fund smaller claims.

18.4. Competence:

In order for a litigation funding entity to be licensed under an AFSL (Dispute Finance), its responsible managers (being persons that have direct responsibility for significant day-to-day decisions about funded claims) ought to have the skills and knowledge that demonstrate competence to effectively provide litigation finance services. LCM submits that in assessing whether a person has appropriate skills and knowledge, the licensing body shall consider the person's demonstrated:

18.4.1. Legal education, qualifications and experience;

18.4.2. Insolvency education, qualifications and experience if providing litigation finance in the insolvency space;

18.4.3. Understanding of solicitors' obligations as officers of the Court, and their obligations to their clients; and

18.4.4. Understanding of the requirements of the AFSL (Dispute Finance).

Persons holding a current solicitor's practising certificate in Australia and members of the Institute of Chartered Accountants should be deemed to satisfy the above requirements.

LCM further submits that litigation funders should not be required to meet the training and qualification standards with regards to the provision of broader financial product advice.

18.5. Wholesale v Retail:

As noted in Part A above, litigation funding is not only used in retail class actions, but is more commonly utilised by insolvency practitioners and is increasingly employed as a finance solution by sophisticated Australian businesses.

Consequently, the AFSL (Dispute Finance) ought to have requirements that are akin to an AFSL for the provision of financial services to wholesale clients. LCM submits that the requirements of a retail licence are unnecessarily onerous given the context of most litigation funding arrangements.

Importantly, any argument in favour of a retail licence is likely to focus on the provision of litigation funding in a retail class action setting. However, LCM stresses that in such claims the funding agreement is already the subject of

strict supervision by the Court, which plays a protective role over the interests of those retail class members. Consequently, such class actions are not a suitable supporting example for the implementation of retail requirements for all litigation funding operations.

18.6. Overlapping regulation:

LCM submits that publicly listed entities with market capitalisation of over $50million should be deemed to satisfy the financial resource and reporting requirements for an AFSL (Dispute Finance).

MIS Regime

19. As noted above, LCM supports the increased transparency, accountability and professionalism within the litigation funding industry. LCM also supports the requirement that funders hold a tailored AFSL (Dispute Finance).

20. However, LCM only advocates regulation that is relevant and effective in achieving its stated objectives.

21. LCM further notes that when providing litigation funders with an exemption from the MIS provisions, the Government indicated that[3]:

"The Federal Court's decision[4] would have imposed a wide range of requirements that apply to MIS, such as registration, licensing, conduct and disclosure requirements on litigation funders and their arrangements with their clients. The Government considers that these requirements are not appropriate for litigation funding schemes. The Government supports class actions and litigation funders as they can provide access to justice for a large number of consumers who may otherwise have difficulties in resolving disputes. The Government's main objective is therefore to ensure that consumers do not lose this important means of obtaining access to the justice system."

22. LCM respectfully supports the above sentiment.

23. Unfortunately, there is presently limited information available on how the MIS regime may be able to apply to class actions and litigation funding. On a plain reading of the Corporations Act and Regulations, the MIS regime does not contemplate or naturally apply to representative proceedings or to products akin to litigation finance. In some respects, it may be impossible for funders to be compliant, or strict compliance may be counterproductive to the interests of class members.

24. In the absence of further information, LCM has concerns about the utility and effectiveness of the MIS regime in the context of class actions and litigation funding unless that regime is subject to considerable adaptation. Although LCM will continue to review its position as further details come to light, on the basis of information presently available, LCM's concerns can be summarised as follows:

[3] Explanatory Statement, Select Legislative Instrument 2012 No 172

[4] In *Brookfield Multiplex Limited v International Litigation Funding Partners Pte Ltd* (2009) 260 ALR 643

24.1. Incongruence with class action regime:

LCM is concerned that if class members are required to participate in an MIS in order to participate in a class action, this would have the following negative effect on the fair and equitable outcomes for plaintiffs:

24.1.1. End of "opt out":

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

Most recently in *Haselhurst v Toyota Motor Corporation Australia Ltd* [2020] NSWCA 66 and in *Wigmans v AMP Ltd* [2020] NSWCA 104, the New South Wales Court of Appeal reiterated that the opt-out nature of Australian class actions has long been recognised to be an important aspect of the legislative regime.

If class members are required to participate in an MIS (by accepting a Product Disclosure Statement etc) in order to participate in a class action, the requirement for this positive action would shift class actions from an "opt out", to an "opt in" model.

This change would reverse the approach to class member participation that has been a consistent and important feature of Australian class actions since its inception, which would have far-reaching consequences.

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

"It ensures that people, particularly those who are poor or less educated, can obtain redress where they may be unable to take the positive step of having themselves included in the proceeding"[5]

Consequently, LCM submits that the "opt out" nature of class actions is integral to the regime, and that the introduction of anything akin to an "opt in" model would cut against the regime's objectives and would negatively impact fair and equitable outcomes for plaintiffs.

24.1.2. End of "open class":

As a consequence of the "opt in" model discussed above, it would no longer be possible to progress class actions on an "open" basis: if a class action could not be progressed on behalf of a party that had not consented to participate in the MIS, class definitions will undoubtedly begin to be limited to only include parties that have done so.

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

This consequence is in direct conflict with the First Recommendation of the Australian Law Reform Commission that "Part IVA of the *Federal Court of Australia Act 1976* (Cth) should be amended so that all representative proceedings are initiated as open class"[6].

24.1.3. Greater uncertainty for defendants; return of multiplicity of actions:

The curbing of "open class" proceedings will see an accelerated return to book building and "closed class" claims.

As a result, instead of facing one open class action the resolution of which achieves certainty and finality for a defendant, defendants may face a number of closed class proceedings, each operated as a separate MIS.

The defendant will have no certainty when concluding one claim, that another (with different MIS members) is not going to follow.

24.1.4. Interference with Court supervision:

Class actions are obviously progressed by way of Court process and are conducted under Court supervision. It is also an explicit requirement of all Australian class action regimes that the proceeding cannot be resolved or discontinued without the Court's approval.

LCM submits that great care needs to be taken in introducing an MIS regime to ensure that the regime does not usurp or fetter the Court's powers, or interfere with the Courts' overarching purpose of facilitating the just resolution of disputes according to law as quickly, inexpensively and efficiently as possible[7]. It must be an explicit feature of any introduced regime that Court Rules and orders must prevail if a conflict arises with the operation or regulation of the MIS.

The above comments proceed on the assumption that all class members would be required to participate in an MIS in order to participate in a class action. LCM also acknowledges that what may be envisaged is that only <u>funded</u> class members would have to be members of a Scheme. However, this narrowing does not alleviate the above issues. If a funder is only able to seek a return from a party that has engaged in the MIS, pursuing an "open class" proceeding would be unworkable. All non-MIS class members would be "free riders" at the expense of the MIS class members, who would have to carry the full load of the legal and funding costs incurred in the claim. Since an MIS is to be operated for the benefit of its members, an "open class" proceeding with known "free riders" would not be in the best interests of the Scheme's members and would consequently be impermissible.

24.2. <u>Incongruence with litigation funding products:</u>

The way that MIS regulations are presently framed does not sit comfortably with any litigation funding agreement. Although it may be technically possible

[6] Australian Law Reform Commission Report "Integrity, Fairness and Efficiency - An Inquiry into Class Action Proceedings and Third-Party Litigation Funders".

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

to apply the definition of an MIS to a funded class action, this is not the case for the regulations that would then apply to these proceedings.

By way of example, even the basic role of the litigation funder in an MIS is ambiguous.

Presumably, the assumption underpinning the introduction of the MIS regime in this context is that the funder would be the scheme's "operator". However, "operate" refers to the acts which constitute the management of, or the carrying out of the activities which constitute, the MIS. A litigation funder does no such thing in a class action. It is the lead applicant who provides instructions to the solicitors. It is the solicitors that undertake the day-to-day conduct of the claim, communicate with class members, communicate with experts and opposing counsel, and with the Court. The Court supervises the action and makes orders in relation to the way the action is to proceed. The litigation funder merely pays the lawyers' invoices. How can the litigation funder then be said to "operate" the class action?

24.3. Cost:

The cost of complying with the MIS regime will be considerable and will dramatically increase the cost associated with commencing any class action.

The policy and purposes underlying Part IVA of the Federal Court Act were identified in the second reading speech for the Bill that introduced it:

"The Bill gives the Federal Court an efficient and effective procedure to deal with multiple claims…(One of its purposes is) *to provide a real remedy where, although many people are affected and the total amount at issue is significant, each person's loss is small and not economically viable to recover in individual actions. It will thus* ***give access to the courts to those in the community who have been effectively denied justice because of the high cost of taking action****…"*[8] (emphasis added)

LCM submits that a step that increases the cost of class actions will go a long way to "effectively deny justice" to class members by creating an unjustifiable barrier to the commencement of claims.

This is particularly concerning when the added cost may otherwise offer no meaningful value to class members or provide them with any added protection.

24.4. Grandfathering:

Many funded class actions are presently on foot and progressing through the Court process under the management of an assigned Judicial Officer.

If the proposed regulatory changes were not brought in with a grandfathering to carve out claims filed before 22 August 2020, most of the class actions lists

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

in Australian Courts would immediately grind to a halt on 22 August. In particular, LCM notes that:

24.4.1. MIS regulation applies not only to the formation of a scheme but also to its ongoing operation;

24.4.2. Consequently, despite class members of all existing class actions already being defined as group members of those proceedings, and some of them being party to litigation funding agreements, all class actions could not continue until such time as each of these persons is retrospectively identified and included into an MIS;

24.4.3. Most "open" class actions would need to be closed by reference to the particular MIS(s) that group members participate in. Most "closed" actions would need to have their membership redefined;

24.4.4. Otherwise, class actions would need to offer their class a further opportunity to opt out (despite the fact that they may have been offered that opportunity before and have made the decision to remain in the proceeding). If those group members do not take the positive step of opting out, their claims would be extinguished if the class action they were a party to was unable to proceed;

24.4.5. Thousands of group members would be significantly delayed and prejudiced in the progress of their meritorious claims. Many of them would have their position dramatically and negatively changed - from being a member of a class action and anticipating its benefit, to having no claim progressed on their behalf and no hope of a recovery for the damage they have suffered.

This approach would clearly have a significant negative effect on the fair and equitable outcomes for plaintiffs.

24.5. Ineffectiveness:

Although there has been no explicit policy objective stated for the introduction of the MIS regime in the context of funded class actions, the objectives of broader reforms have been variously reported as a) group members receiving a larger share of proceeds, b) preventing unmeritorious class actions, c) protecting businesses under Covid-associated stress from unfair class actions, and d) ensuring that plaintiffs are able to meet adverse costs orders if their claims are unsuccessful.

It is difficult to see how the requirement to comply with the MIS regime could, without considerable legislative adaptation, effectively serve any of the above objectives.

Australian Financial Complaints Authority ("AFCA")

25. LCM notes that the introduction of the proposed regulation without adaptation would see litigation funders being required to become members of AFCA.

26. LCM supports the fair, efficient and independent resolution of disputes and complaints in the unlikely case that one arises. LCM also submits that there is presently no

evidence to support an argument in favour of compulsory AFCA membership for the funding industry. In the absence of such further evidence, LCM suggests that AFCA may not be the best forum for resolution of the disputes and complaints that may arise between funders and users of funding products.

27. In making the above submission, LCM stresses the paramount importance of efficiency in any compulsory dispute resolution process in this context. Litigation funding services naturally operate in parallel to an adversarial legal proceeding, which must at all times be progressed in an efficient and timely way. The dispute resolution process ought not be capable of delaying or adversely impacting the underlying legal proceeding.

28. It is also of critical importance that any complaint-handling procedure offers a confidential method of dispute resolution and adjudication, so as to limit the risk that the defendant in the substantive claim may indirectly obtain confidential information or other tactical advantage.

29. Anecdotally, LCM's standard dispute resolution mechanisms follow a robust process through which the parties are directed to a prompt conciliation meeting which, if unsuccessful, is followed by a prompt and binding arbitration before a legally qualified arbitrator agreed by the parties or, in the absence of agreement, by a person selected by the President of the Law Society in the relevant State. The costs of the arbitration are then borne as the arbitrator decides. In LCM's experience, this process allows for prompt, efficient, confidential and fair resolution of disputes and complaints.

30. Additionally, in the context of class actions LCM again reiterates that the Court already has a supervisory and protective role over the interests of class members. AFCA's compulsory involvement in such claims may purport to fetter or usurp these supervisory powers.

PART D: FUNDER COMMISSIONS IN CLASS ACTIONS

Whether the present level of regulation applying to Australia's growing class action industry is impacting fair and equitable outcomes for plaintiffs, with particular reference to the following:

Item 1: What evidence is available regarding the quantum of fees, costs and commissions earned by litigation funders and the treatment of that income

Item 2: The impact of litigation funding on the damages and other compensation received by class members in class actions funded by litigation funders

- **Reliable evidence of fees, costs and funding commissions available in Courts' settlement approval decisions**
- **Evidence shows that class members receive the bulk of settlement proceeds**
- **In the absence of funding, majority of class members would have received nothing**
- **LCM advocates against the introduction of pre-determined outcomes, such as fixed minimum returns for class members**

Evidence

31. Every class action regime in Australia is accompanied by a requirement that a class action cannot be resolved or discontinued without the approval of the Court and that, if the Court gives such approval, it may make such orders as are just with respect to the distribution of any funds recovered under a settlement.

32. LCM submits that this is important for two reasons.

33. Firstly, it means that every payment of "fees, costs and commissions earned by litigation funders" ("Funding Costs") has been carefully considered by a Court that exercised a supervisory and protective role over the class members that were in effect paying those commissions. This is discussed further below.

34. Secondly, it means that payments of Funding Costs have been the subject of public Court decisions. Such decisions provide substantial reliable evidence of the "fees, costs and commissions earned by litigation funders". With respect to the recent trends in these integers, judgments containing the reasons for the orders made with respect to settlement approval applications were issued with respect to 92.8% of the *Part IVA* settlement agreements in the five-year period commending 2014[9].

35. By way of a brief summary of what an analysis of this evidence may suggest, Professor Morabito's "An Evidence-Based Approach to Class Action Reform in Australia" found that:

[9] "Looking into the Fishbowl – Open Justice and Federal Class Action Settlements", Morabito (2019) 93 ALJ 446 at 446

35.1. 26.87% of the settlement proceeds generated in all funded class actions ($582,953,453 out of $2,169,021,672) were applied towards the funding fees of the funder supporting the litigation; and

35.2. In approximately two-thirds of all funded cases settled in the last 27 years, class members received more from class action settlements than solicitors, funders, barristers and various experts combined.

36. Professor Morabito further commented that:

"As far as I have been able to ascertain, the higher figures that have frequently been mentioned in the media and the legal literature appear to be attributable, to some extent, to: (a) reliance on only the better-known class action settlements; and/or (b) incorrectly treating funding commissions and the total payments received by litigation funders, pursuant to class action settlement agreements, as being the same thing".

Possible reforms

37. In light of the evidence summarised above, LCM suggests that the assistance of litigation funders has historically achieved good returns for class action participants.

38. However, despite the clear available evidence and the existing supervisory role of the Court, various proposals continue to be put forward to change the operation of funded class actions.

39. For the purposes of this submission, LCM focuses on the proposal to fix a minimum return for class members and the proposal for class actions to operate as managed investment schemes.

Impetus for reform?

40. The Courts have been active in considering and developing criteria to be considered when approving, and ultimately modifying and setting, the Funding Costs in class actions. They have indicated that Funding Costs ought to be fair and reasonable, and proportionate in terms of the sums invested and the risk undertaken by the funder.

41. LCM submits that Courts ought to continue to oversee the distribution of settlements, and LCM opposes provisions that would fetter judicial power by imposing predetermined outcomes. LCM advocates for continued recognition of the nuanced and multifaceted nature of settlement applications, and the need for flexibility in judicial consideration of Funding Costs on a case-by-case basis.

42. By way of example, LCM refers to the recent decision of the Honourable Justice Foster in *Cantor v Audi Australia Pty Limited (No 5)* [2020] FCA 637, where after careful consideration of the particular facts of the case, the Court refused to grant the common fund order sought by the funder altogether and concluded that (at [472]):

"In the proper exercise of the Court's discretion, the Court should not sanction such entrepreneurial activity entered into solely for the financial benefit of [the funder] *and in complete disregard of the interests of group members."*

43. The advocates for change point to well-worn singular examples of class actions in which the group members received less than 50% of a settlement. However, the use of these examples does not bear close scrutiny.

44. In order for a settlement to be approved and for distributions to be made, the Court must have conducted a detailed review of all the circumstances, including objections from any class members dissatisfied with the resolution and advice from senior counsel as to why the settlement is fair and reasonable. The Court also offered class members an opportunity to opt out of the settlement if they were not satisfied with it.

45. The Court was then satisfied that a) the resolution amount was reasonable; b) the payable costs are reasonable; c) the payable funding commission is reasonable; and d) the settlement distribution scheme was fair and reasonable as between the group members.

46. In light of the above, the only sensible conclusion that can be drawn in these unfortunate and rare cases is that the class members incurred reasonable costs in progressing their class action, achieved a reasonable outcome that was less than what they hoped, but were nevertheless more satisfied with accepting that outcome than not accepting it (i.e. they did not opt out).

47. LCM submits that this result, while never strived for, is nevertheless an age-old risk for any claimant embarking on a piece of litigation.

48. Litigation is unpredictable and risky, and the cost of advancing a claim, particularly against an adversarial defendant, can have a very significant impact on the action's ultimate proceeds. This is true of both funded and unfunded proceedings, both commercial claims and class actions. However, the services of a litigation funder allow the rights of a litigant to be enforced with that litigant facing no risk or cost, while retaining an interest in any net upside. And it is merely a commercial reality that those funding services have a cost, just like the services of a solicitor. It is obvious to also add that in the absence of funding and legal assistance (the costs of which were confirmed by the Court to be reasonable) the class members would have recovered nothing.

<u>Restrictions on group member returns</u>

49. Turning to specific proposals to fix a minimum percentage for class members, LCM submits that rather than improving outcomes for class members (which it may do in a small number of claims) the overall effect of the proposal would have a negative effect on the long term fair and equitable outcomes for plaintiffs.

Structure of proposal

50. It must be highlighted that the legal costs that are approved in a class action are borne by the funder over the course of the matter, with no certainty that these costs will be recovered. It is the funder that outlays those costs and carries the risk that they will not be reimbursed (and, worse, that adverse costs will also need to be met). Legal costs do increase throughout the life of the proceedings, at times beyond the levels that were anticipated at the commencement of the action. Claim quantum and settlement expectations have also been known to scale downwards as a case evolves.

51. In light of the above, LCM submits that the use of predetermined caps for funding commissions based only on the quantum of an ultimate recovery (and ignoring the risk and cost borne along the way) fail to properly or fairly recognise the true nature of the funding arrangement.

52. Further, LCM submits that the introduction of predetermined caps not only fetters the Court's powers to adjudicate whether Funding Costs are reasonable, but importantly

fetters prospective class members' rights to freely contract for a commission rate that they may otherwise consider to be reasonable, appropriate and commercially advantageous to them. The limitation of the litigation funding market in this way can only serve to constrict it, negatively affecting the long term fair and equitable outcomes for plaintiffs.

53. Critically, LCM strongly advocates against any predetermined outcomes that may be based on a percentage of the gross recovery, rather than the net recovery after allowing for costs. By way of an example, if a funder incurs costs of $7 over the course of a claim and the ultimate recovery is $10 (including a reimbursement of the $7 in costs), LCM submits that it is manifestly unfair to guarantee the class members a fixed percentage of the $10 total. If that fixed percentage were to be set at 50%, the group members would receive $5 out of the $10 recovery. $2 of that amount would represent a reimbursement of costs. But the class did not pay any costs, the funder did. Why should the class receive a reimbursement for them, and at the expense of the funder (who will suffer a $2 loss, despite the costs that it paid being found by a Court to have been reasonable)?

54. LCM advocates against the use of any predetermined outcomes. However, if such measures were to be introduced, LCM submits that in order for them to be in any way "fair and equitable" they could not be set by reference to gross returns, but only by reference to the net returns achieved in the claim, after the deduction of all costs (which should be reimbursed to the party that paid them).

55. As to the quantum of the proposed percentages (if such outcomes were to be fixed), LCM submits that it is presently impossible to sensibly make an assessment of funders' future risks and costs, and consequently impossible to formulate an argument on the quantum of "fair and equitable" funder returns. The uncertainty associated with the potential introduction of the AFSL and MIS requirements has the effect that past experience in funding commissions may be entirely irrelevant in future. The substantial cost of compliance with the MIS regime also cannot be absorbed by funding businesses. In the long term, it will be indirectly passed to class members. Consequently, LCM does not make submissions about the appropriate quantum of any caps that may be introduced, save as to reiterate that LCM argues against the use of any predetermined outcomes and to submit that this argument has particular force when the industry is going through a significant regulatory shift.

Effect on long term fair and equitable outcomes

56. Between 2013 and 2018, 64% of filed Federal Court class actions received third-party funding, and between March 2017 and 2018 that percentage increased to 78%[10].

57. In the event that funder returns are capped in a way that does not fairly reflect the commercial risk being accepted, this will inevitably chill the interest of litigation funders and the interest of those that invest in litigation funding businesses. Fewer meritorious actions will be funded.

58. Importantly, if meritorious actions are not funded, it does not mean that they progress as unfunded claims. LCM submits that a very small percentage of "fundable" claims would be commenced and progress to a resolution unfunded. Advocates for change refer to the (obvious) fact that group members receive a greater proportion of the

[10] Australian Law Reform Commission Report "Integrity, Fairness and Efficiency—An Inquiry into Class Action Proceedings and Third-Party Litigation Funders", Table 3.2.

settlement award in unfunded matters, comparing a 51% median in funded against an 85% median in unfunded claims. LCM submits that this is not an accurate comparison. If the action is not funded and therefore does not proceed, the comparison is not between 85% and 51% of a settlement, it is between 51% of a settlement and 100% of nothing.

MIS regime

59. LCM refers to its submissions on the applicability of the MIS regime in Part B above. For the purposes of this Part C LCM reiterates that:

59.1. It is difficult to see how the requirement to comply with the MIS regime could, without considerable legislative adaptation, effectively serve the objectives of increasing returns to class members;

59.2. For the reasons set out in Part B above, the requirement that class actions operate as an MIS would considerably increase the costs of class actions and would create barriers to the commencement of certain claims;

59.3. The introduction of the MIS regime without adaptation would negatively impact the fair and equitable outcomes for plaintiffs.

PART E: CONTINGENCY FEES

Whether the present level of regulation applying to Australia's growing class action industry is impacting fair and equitable outcomes for plaintiffs, with particular reference to the following:

Item 3: The potential impact of proposals to allow contingency fees and whether this could lead to less financially viable outcomes for plaintiffs

Item 4: 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

Item 11: 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

- **Contingency fees may not increase long term returns to class members**
- **Introduction of contingency fees will mean end of "no win, no fee" claims**
- **Funders do not control class actions**
- **Contingency fee arrangements carry inherent risk of a conflict of interest**

60. By way of general observation, in its role as a litigation funder LCM does not take a view on whether solicitors ought to be permitted to enter into contingency fee agreements. Although LCM acknowledges that the introduction of contingency fee arrangements has some prospect of increasing competition in litigation funding products, LCM sees this potential development as an opportunity.

61. In the above context, LCM provides the following comments on the relevant Terms of Reference.

Cost / financial outcomes for plaintiffs

62. Advocates of lifting the ban on contingency fees in class actions suggest that the overall cost to clients would be substantially lessened by reason of increased competition in the industry, and there being "one less mouth to feed" in the funding arrangement.

63. LCM submits that this is an oversimplified view of third-party funding products and pricing, and submits that the introduction of contingency fee arrangements is unlikely to put downward pressure on funding costs.

64. Although LCM acknowledges the economics of increased competition, LCM notes that in Australia there is a limited number of class action firms that would have the balance sheet required to finance a book of class actions.

65. LCM also respectfully submits that advocates of contingency fees do not give sufficient weight to the commercial risks, pressures and imperatives that inform a funder's commission. Experienced funders do not simply set funding terms at an arbitrary rate.

The rates are arrived at by a careful analysis of the claim at hand as well as a disciplined consideration of broader factors that make a litigation funding business viable in the long term.

66. LCM submits that in the event that lawyers effectively assume the same risks and costs as that faced by a funder, including the very real risk that some matters will not succeed and will result in considerable losses, it is unrealistic to expect that the lawyers' financial considerations would not drive their contingency fee rates into a similar range to that of litigation funding commissions.

67. LCM further presumes (and advocates) that lawyers availing themselves of the opportunity to charge on a contingency basis would be subject to the same licensing regulations that would apply to litigation funders. This would increase the costs for lawyers and would further decrease the already small number of firms that have the commercial capacity to fund class actions.

68. Consequently, LCM submits that it is far from given that lifting the ban on contingency fees will increase the "financial viability" of outcome for plaintiffs.

69. It is also important to note that in introducing contingency fees, the regulation will effectively wipe out the use of "no win, no fee" arrangements. This will have the effect of decreasing that "financial viability" for certain claims.

70. At present, solicitors are able to provide services on a speculative "no win, no fee" basis and charge a capped uplift on their deferred fees. LCM submits that the introduction of contingency fees will result in fewer (if any) matters progressing on a "no win, no fee" basis, when the lawyers are able to charge on a contingency instead.

71. Basic commercial sense also suggests that lawyers will not agree to fund smaller claims on a contingency basis, if those claims do not at least offer the prospect of a return commensurate with the "no win, no fee" model, being the opportunity cost of the firm charging its solicitors on an hourly basis, plus a commission to allow for the time value of money and the risk of a complete loss.

Conflict / control

72. In LCM's experience, skilled class action lawyers are mindful of their duties in class action proceedings and are careful and considered in managing those duties as well as any actual or perceived conflicts of interest that may arise.

73. LCM also pauses here to expressly address the question of a funder's control in a class action.

74. In summary, it is the lead applicant in a class action that provides the instructions and it is the solicitors that undertake the day-to-day conduct of the claim. Aside from key matters, such as settlement, LCM does not seek to interfere in the matter, and never in the lawyers' relationship with their clients. By way of example, this issue was recently considered in the Queensland Supreme Court, where it was found that LCM's litigation funding agreement did not provide "any level of unlawful or improper control" to LCM[11].

75. In the context of the contingency fee debate, LCM further submits that it is almost impossible to see how any control or conflict issues that may be said to exist or arise

[11] *Murphy Operator & Ors v Gladstone Ports Corporation & Anor (No 4)* [2019] QSC 228

in a tripartite funding arrangement (client, lawyer and funder) could be anything but exacerbated by merging the interests of two out of the three parties (the lawyer and funder).

76. By way of illustration, if the lawyers accept the role of a funder in addition to their role of advisor, they will face a daily tension between their ethical and professional duties to the Court and to the litigant, as against their own interests and their objectives to:

76.1. Minimise professional fee earners' time on a matter;

76.2. Minimise disbursement outlay;

76.3. Minimise adverse costs risk;

76.4. Maximise return; and

76.5. Manipulate the timing of a resolution, depending on the lawyers' own cash flow and other commercial pressures.

77. Although the above interests can, of course, motivate a funder, LCM submits that in practice the separation between the funder and the lawyers, the funder's limited ability to take steps without the lawyers' involvement and the litigant's approval, and the lawyers' overriding duty to act in the interest of the litigant, all serve as effective safeguards for that litigant's interests.

78. Presently, the lawyers can advise a litigant to take a course that may be contrary to the interests of the funder. However, if the lawyers are the funder, they will be constantly faced with decisions on how and when to disclose specific conflicts to clients, and how and when to advise clients against the lawyers' own interests. The resulting minefield is unlikely to be entirely transparent, nor easily regulated.

PART F: CLASS ACTIONS AND THE ECONOMY

Whether the present level of regulation applying to Australia's growing class action industry is impacting fair and equitable outcomes for plaintiffs, with particular reference to the following:

Item 9: What evidence is becoming available with respect to the present and potential future impact of class actions on the Australian economy

Item 12: The potential impact of Australia's current class action industry on vulnerable Australian business already suffering the impacts of the COVID-19 pandemic

- **LCM assists "vulnerable" businesses and does not fund class actions against them**
- **Litigation finance is an important tool for companies seeking to preserve capital**
- **Continuous disclosure rules engender trust in markets and encourage investment**
- **Relaxation of disclosure rules contrary to ongoing viability of markets and availability of capital**

LCM and "vulnerable" Australian businesses

79. At the outset, LCM unequivocally states that it is not funding or pursuing class action claims against any "vulnerable Australian business already suffering the impacts of the COVID-19 pandemic".

80. LCM respectfully submits that it is a nonsense to suggest that hyena-like funders are salivating over the pandemic and readying to pounce on limping companies.

81. Firstly, the pursuit of a claim against any "vulnerable" defendant is wholly uncommercial. It is not attractive to any prudent funder, plaintiff law firm or class member.

82. Secondly and more importantly, rather than seeking to attack "vulnerable" corporate players, LCM is presently continuing to work with businesses that are looking for added ways to manage their cash flow at this time.

83. LCM refers to its submissions under "Funding Corporate Australia" in Part A above and reiterates that LCM has a particular focus on corporate portfolio funding, being the provision of non-recourse finance facilities to corporate clients.

84. Particularly in times of economic instability, companies acting prudently seek to preserve their capital and limit the use of cash for non-core expenditure. By providing a finance solution for the company's disputes and securing that finance only against the company's claims (rather than any of its operating assets), LCM adds an important tool to corporate Australia's financial toolkit. This tool is particularly effective in challenging economic times and particularly valuable to "vulnerable" businesses.

85. Further information on LCM's corporate funding products can be found at https://www.lcmfinance.com/solutions/.

Class actions and the economy

86. LCM notes that shareholder claims are the most commonly filed class actions in the Federal Court, representing 34% of all class actions filed in the last five years[12]. LCM further notes the announcement of the Honourable Josh Frydenberg MP on 25 May 2020 that continuous disclosure regulations will be temporarily relaxed so that companies and their officers will only be liable for breach if there has been "knowledge, recklessness or negligence" with respect to updates on price sensitive information to the market.

87. It is in this context that LCM provides the below comments on the relevant Terms of Reference. However, LCM notes that pure continuous disclosure claims are not, and never have been, a focus of LCM's business.

88. As a publicly listed company, LCM understands and values the importance of a transparent and fully functioning market, and the rules that underpin it.

89. LCM appreciates the favourable legal and economic impact of the continuous disclosure legislation, including its importance in reducing information asymmetry between companies and investors, maintaining confidence of market participants and, critically, encouraging greater investment into the corporate entities that are listed on the exchange.

90. LCM submits that a permanent relaxation, if effected, could create far-reaching and drastic consequences contrary to shareholder interests and, ultimately, contrary to the ongoing viability of securities markets and the availability of capital. LCM further submits that any measure that has the effect of tightening the availability of capital should be approached with particular caution in times of recession.

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[12] Australian Law Reform Commission Report "Integrity, Fairness and Efficiency—An Inquiry into Class Action Proceedings and Third-Party Litigation Funders" at [1.11]

PART G: COMMON FUND ORDERS

Whether the present level of regulation applying to Australia's growing class action industry is impacting fair and equitable outcomes for plaintiffs, with particular reference to the following:

Item 7: The application of common fund orders and similar arrangements in class actions

- **Common fund orders would improve fair and equitable outcomes for both plaintiffs and defendants**

91. At the outset, LCM notes that the application of the MIS regime for class actions may render common fund orders an impossibility. LCM refers to its submissions under the heading "MIS regime" in Part B above.

92. Nevertheless, LCM also notes that it was a recommendation of the ALRC Report that 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.

93. LCM submits that if there were an express statutory power to make common fund orders, such orders would positively impact fair and equitable outcomes for plaintiffs. Importantly, LCM submits that they would also positively impact fair and equitable outcomes for defendants.

94. LCM notes paragraph 15.4 of the Federal Court Class Actions Practice Note (GPN-CA), which presently states:

> *"Particularly in an open class action, the parties, class members, litigation funders and lawyers may expect that unless a judge indicates to the contrary the Court will, if application is made and if in all the circumstances it is fair, just, equitable and in accordance with principle, make an appropriately framed order to prevent unjust enrichment and equitably and fairly to distribute the burden of reasonable legal costs, fees and other expenses, including reasonable litigation funding charges or commission, amongst all persons who have benefited from the action".*

95. However, LCM further notes that following the issue of the Practice Note, the Federal Court has also declined to grant common fund orders in *Fisher (trustee for the Tramik Super Fund Trust) v Vocus Group Limited (No 2)* [2020] FCA 579 and *Cantor v Audi Australia Pty Limited* (No 5) [2020] FCA 637.

96. LCM submits that the Practice Note alone does not offer sufficient certainty for a prudent litigation funder to invest considerable sums (usually in excess of $5million) into a class action without also undertaking a book build in order to guarantee a minimum return.

97. The increased commercial imperative to book-build is likely to lead to an increase in "closed" class actions, being claims that are defined to only include persons that signed a funding agreement with a particular funder or, depending on how proposed regulations develop, persons that are members of a particular MIS.

98. As discussed in Part C above, the move towards “closed” class claims increases the risk of multiple class actions being run in one court or across different courts against the same defendant. This may have the effect of increasing defendant costs, as they may need to face multiple “closed” claims instead of one “open” claim. Defendants will also never have certainty nor finality in resolving any one “closed” class action, as that resolution would not prevent another “closed” claim being commenced in relation to the same set of facts.

99. Conversely, the granting of statutory power to make common fund orders would offer “fair and equitable outcomes” for both plaintiffs and defendants by ensuring every claim is only litigated once, and that the costs of that litigation are borne evenly by all persons that benefit from its resolution.