20th August 2017

Victorian Law Reform Commission
3/333 Queen Street
Melbourne VIC 3000

Dear Commissioners,

Re: Access to Justice – Litigation Funding and Group Proceedings

Thank you for the opportunity of making a submission to your reference on *Access to Justice – Litigation Funding and Group Proceedings*. My submission will address a number of matters raised by your terms of reference including the potential scope of reform, the clarification and strengthening of legal practitioner duties qua litigation funding of class actions, improvements in judicial communication and processes, multiple class actions and the impact of the common fund approach, and whether the introduction of contingency fees would mitigate issues associated with litigation funding. Prior to addressing these issues, I will make a few general comments about litigation funding and class actions.

My submission is appended.

Yours sincerely,

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1. General comments

As the VLRC notes the advent of commercial litigation funding has reduced the cost barrier for initiating prolix and resource intensive class action litigation by underwriting the cost of prosecuting class actions and by indemnifying class representatives against adverse costs. As a result, overall litigation funding has had a positive impact on access to justice, albeit a limited one. Certainly, at the federal level it is clear that without litigation funding, the number of class actions instigated in Australia would fall to a trickle. However, much fewer class actions are initiated in Victoria and of these a much lower percentage have received support from litigation funders. Consequently, the impact upon Victorian class actions has not been as significant as in the federal jurisdiction. Therefore it will be difficult to generalise from Victoria's limited litigation funding experience.

The catalyst for the reference was a suggestion that some class actions were instigated purely to aggrandize litigation funders and class action law firms and have resulted in large payouts to funders and class law firms with little return to class members. That suggestion appears to be based on a number of anecdotal examples rather than empirical analysis of the returns received by class members versus law firms versus funders. Mean and median returns (with some correlation to merits) would be a more useful yardstick. Several examples are listed at 1.12 of the VLRC's Discussion Paper. Notably only in the Huon Corporation case were funders involved, and the Huon matter was not a class action.

Aside from these isolated cases that do not appear to involve litigation funding of group proceedings, there is little evidence that litigation financing is working dysfunctionally and that the courts are ill equipped to cope. Where potential abuse of process has been identified the courts have been able to use their inherent power to stay the proceedings. Examples include:

(1) *Melbourne City Investments Pty Ltd v Myer Holdings Ltd* [2017] VSCA 187 – stay ordered where the predominant purpose of instigating the class proceedings was to generate legal fees as the amount of return to class members was negligible compared with the costs of prosecuting the action

(2) *Walsh v Worleyparsons Ltd (No 4)* [2017] VSC 292 – proceedings stayed as Melbourne City Investments was predominant party behind the litigation and had already been previously prevented from pursuing the matter.

(3) *Melbourne City Investments Pty Ltd v Treasury Wine Estates Ltd* (2016) 243 FCR 474 – proceedings stayed where the predominant purpose was to earn legal fees

(4) *Treasury Wine Estates Ltd v Melbourne City Investments Pty Ltd* (2014) 45 VR 585 – proceedings stayed where the predominant purpose of the proceedings was to earn legal fees for the sole director and shareholder of an entity who was also the class solicitor.

Consequently, the case for regulation is weak. Should regulation be deemed necessary to deter further attempted abuse of process, regulation prohibiting a legal practitioner or class law firm from directly or indirectly holding any share or other ownership in the litigation funder or class representative involved in the proceeding might be implemented. Such regulation has recently been implemented in Singapore and Hong Kong in relation to litigation funding of arbitration proceedings.

Other areas of regulation suggested by the Consultation Paper include: (a) capital adequacy of funders and (b) consideration of disclosure of funding agreements in all funded proceedings.

For constitutional and practical reasons outlined below regulation of capital adequacy of litigation funders would appear problematic. In any event, Courts have power to order security for costs (an obligation which as a practical matter will fall upon funders in most class actions if a funder is underwriting the proceedings) and this power will generally ensure that those funding the proceeding have sufficient resources behind them and that respondent's interests are adequately protected.

I recommend in favour of disclosure of the key terms of the funding agreement in all cases to support settlement (and any application for security for costs), and to ensure that the court and all parties are fully apprised of the nature of the proceedings' financial arrangements. There appears to be little justification for lack of transparency at least insofar as key terms are concerned such as the extent of the indemnity provided for adverse costs, the percentage of recoveries that the funder is entitled to receive and the extent of any other substantial fees.

Should any regulation be pursued, it will be important to craft the regulation so that it is not confined to a particular business model. The Huon corporation case itself referred to earlier is testament to avoiding myopic focus on the particular way in which collective redress is formulated.

Further, new fintech crowdfunding and peer to peer lending forms of class action financing are coming on stream. Examples include:

- Crowdsuit – Crowdsuit acts as a claim aggregator. Consumers assign their claims to Crowdsuit, and funds generated from prosecution of the consolidated claims are donated to charity.
- Lawfunder – Lawfunder is an Australian based crowdfunding platform that matches plaintiffs with parties wishing to either donate or invest in law claims. A prospectus template is provided for investors. There is one 'sample' class action listed on their website: https://www.lawfunder.org/projects/commercial-litigation-opportunity-class-action/.
- Lexshares – Lexshares is an online platform that matches investors with plaintiffs and law firms seeking litigation funding of Lexshares' 'curated' claims. Investors must be accredited under §230.501 US Securities Exchange Regulations.
- Alter Litigation – Alter Litigation is a French litigation funder. It has formulated a scheme of assignment and claims management it calls 'Clemency Xtend'. The scheme rewards cartel members who provide information and evidence of cartel conduct. Should a cartel member provide the relevant information and evidence, Alter Litigation will (i) to enforce the cartel damage claims against the other cartel members only and (ii) assist the Clemency Xtend TM candidate to reduce its risk of successful actions for contribution brought by the other cartel members. The idea is that cartel victims assign their damages claims to Alter Litigation, which is then empowered to selectively sue the cartel members who do not join its Clemency Xtend program.

Any potential regulation should apply to not only litigation funding via a single commercial funder but via networked individual investors using various forms of transaction.

2. Scope for reform

It is important to note that the scope for reform that might be recommended by the Victorian Law Reform Commission is limited by 2 factors, one constitutional and one practical.

a. Constitutional constraints

As a result of *Corporations Regulations 2001* (Cth) 7.1.04N and 7.1.06 (2A) & (2B) an interest in a litigation funding scheme is defined as a financial product and declared not to be a credit facility (thereby overriding the High Court's decision in *International Litigation Partners Pte v Chameleon Mining NL* (2012) 246 CLR 455). Consequently, litigation funding is subject to the requirements of Chapter 7, *Corporations Act 2001* (Cth). However, *Corporations Regulation* 7.6.01AB goes onto provide that Chapter 7 obligations do not apply to litigation funding schemes provided adequate procedures are in place to manage conflicts of interest.

It follows that s 109 *Constitution* would render any state based regulation that dealt with litigation funders as providers of financial products as inconsistent and therefore unconstitutional. Financial product regulation at the Commonwealth level is very broad and among other things incorporates licensing, disclosure requirements, resourcing adequacy, staff training, compensation and dispute resolution. By dint of the Regulations outlined above, the Commonwealth has implicitly made all these matters off limits to State legislatures.

b. Practical constraints

Even if s 109 does not apply as a practical matter going alone with respect to regulation of litigation financing of class actions may simply be met by funders and class law firms shifting their business elsewhere.

However, while the scope for regulating litigation funders is limited there is scope for the clarification and strengthening of the duties of legal practitioners qua litigation funders and class members as well as for improvements in judicial communication and processes.

3. Clarification and strengthening of legal practitioner duties

Currently the *Legal Profession Uniform Law* provides little guidance as to how class law firms should approach litigation funding of class actions. Rather the Uniform Law imposes general obligations regarding written costs agreements, reasonable and fair costs, and conditional costs agreements. The *Legal Profession Uniform Law Australian Solicitors' Conduct Rules 2015* also provide for general ethical obligations such as a solicitor's paramount duty to the court and to justice, the duty to act in the client's best interest and the duty to avoid conflicts of interest. Importantly solicitors must not receive any financial benefit from third parties (eg funders) without clients' informed consent.

More explicit guidance is provided by ASIC Regulatory Guide 248, *Litigation schemes and proof of debt schemes: Managing Conflicts of Interest* (2013). These guidelines require that class law firms and funders manage the conflicts of interest that can arise between them and prospective parties to tripartite funding and retainer agreements. The main obligations on legal practitioners are to manage and document their procedures for managing conflicts of interest, to disclose the conflicts of interest to class members who might be recruited to the litigation funding scheme and an obligation to ensure that where conflict does arise between the funder and members that the members' interests are adequately protected.

Both the Solicitors' Conduct Rules and the ASIC Guidelines are highly dependent on disclosure to clients as an effective prophylactic. Arguably, this dependence is misplaced. Merely stating that the class law firm is paid by the funder, and acts on the funder's day to day instructions does little to assist class members (as it basically states the obvious). Although the ASIC Guidelines go onto require the law firm and funder to explicate how a particular conflict has developed and how it is being managed as it arises, unless there is an independent adviser providing assistance to class members or a more elaborated proscriptive duty of care towards class members there may be a temptation to play down the conflict. For example, prospective scheme members are rarely, if ever, told about how the arrangement between the class law firm and the funder came to be established, whether the class law firm 'shopped around' for funding terms, or whether the funder and class law firm have engaged in multiple repeat transactions (as opposed to being related entities when disclosure is mandated). Rather than impose the cost of an independent adviser it is my recommendation that the VLRC should consider a more elaborated statement of the duty of care owed by solicitors in relation to the conduct of group proceedings, particularly where these are funded. This could act as a roadmap, especially for less experienced, class law firms, and encourage high levels of ethical compliance. For example, the class law firm may be required to provide candid advice to prospective scheme members as to whether the funding arrangements are in their clients' best interests and whether the fees charged are reasonable (in the class action context this would necessarily be generic advice). The class law firm might also be required to demonstrate that it had conducted a reasonable investigation to attain the best possible funding terms. These suggested obligations are required under the New York Bar Association's, Formal Opinion 2011-2: Third Party Litigation Financing.

Apart from the above, the ASIC guidelines do not address conflicts that might arise between the class law firm, funder and non-scheme class members. Arguably this is likely to be an important source of problems. This is exemplified by what occurs when proceedings are instituted as closed class, then when settlement is imminent the class is opened and all members whether funded or not are invited to register to share in the settlement by a stipulated deadline. Where members do not register they are bound by the settlement but precluded from enjoying the compensation generated by the settlement. Although it was not a case involving funded proceedings, the facts of *Kelly v Willmott Forests Ltd (in liq) (No 4)* (2016) 335 ALR 439 illustrate the issues.

4. Improvements in judicial communication and processes
When class members enter litigation funding agreements they are presented with terms that set out the commissions and other charges that will be incurred should a successful settlement be reached or judgment attained. The terms of the funding agreement also set out the funder's obligations. Similarly, when class members enter retainer agreements with the class law firm, the class law firm is required to provide a written costs agreement setting out the basis for legal costs and an estimate of the likely total legal costs. There is no reason for assuming that this is insufficient for even unsophisticated class members at the commencement of the relationship.

The trouble is that the calculus of legal costs, funder commissions and funder fees versus recovery will not be fully and accurately known until settlement or judgment are imminent. Ideally, such figures should be set out in plain English opt out notices that are published to the class so that members can determine whether to opt out. Currently opt out notices are very opaque and do not provide sufficient information for class members to accurately determine whether to opt out. For example, opt out notices rarely set out the funder's commission (let alone whether it is gross or net of recoveries). Analogously, insufficient information is provided to the class when seeking member registration by stipulated deadlines in order to remain entitled to participate in the class compensation pool. A media and communications expert should be employed to design appropriate opt out and class registration notices.

For the same reason, settlement notices also need to be improved so that members are given sufficient opportunity to object to the terms of the settlement.

5. Multiple class actions and the impact of the common fund approach
As the VLRC Consultation paper notes Australian courts have been reluctant to 'pick a winner' and have allowed competing class actions to proceed in parallel. Competing class actions impose high transaction costs on recovery and undercut the efficiencies of class proceedings. They also make it very difficult for respondents to settle because competing class actions increase the number of parties with whom the respondents must negotiate. Nonetheless, Australian courts allow parallel actions on the basis that they offer class members greater choice as to representation and funding, despite scant evidence that competing actions have driven down the cost of funding or led to significant improvements in funding terms.

Following the decision in *Money Max Int Pty Ltd v QBE Insurance Group Ltd* (2016) 245 FCR 191, and assuming the proceeding is commenced as an open class, there is likely to be increased pressure on the courts to nominate a class law firm and funder team to take carriage of a single proceeding rather than to allow competing actions to continue. The VLRC suggests that a pre-commencement hearing may be required where the right to represent and fund proceedings are subject to tender. If this approach were adopted the tender criteria would be transparent and specified in regulations or Practice Notes. Since competing class actions are likely across federal and other state boundaries, ideally such a solution should be implemented on a uniform national basis and protocols would be required for judicial co-operation between jurisdictions.

6. Contingency fees

In its report on *Access to Justice Arrangements 2014* (at pp 625 – 629) the Australian Productivity Commission recommended that law firm charged contingency fees should be permitted with recoveries capped on a sliding scale for retail clients and no limits placed on recoveries from sophisticated clients. The Productivity Commission was of the view that permitting contingency fees would increase price innovation and choice for claims funding. It was not convinced that contingency fees would create insurmountable conflicts of interest between law firms and clients and was of the view that contingency fees would actually better align interests by forcing law firms to more carefully weigh the costs and benefits of legal services delivery. After all, even without contingency fees class law firms have a financial interest in the class action and its outcome. The interest in maximising per hour fee generation from the proceedings is as much a source of conflict of interest between the class law firm and class members as is the interest a law firm may have in achieving a percentage of class action recoveries.

Apart from ushering in innovation and choice, it is also likely that the introduction of contingency fees will drive down the cost of claim funding. For example, a law firm charging a 30% recovery fee would impose less transaction costs on a class action than payment of legal fees plus a funder charging a 30% recovery fee.

The Productivity Commission's recommendations have been endorsed by the Law Institute of Victoria (*Percentage-Based Contingency Fees: Position Paper,* 2015) and reiterate an earlier recommendation from the VLRC (*Achieving Greater Access to Justice: A New Funding Mechanism,* Victorian Law Reform Commission, 2008, 687).

Clearly, there is a high level of unmet demand for class action funding in Australia. Litigation funders generally will only fund a small amount of claims proposals that are put before them and will usually only fund certain categories of claim (easy to assess, relatively homogenous and large scale). Small sized claims involving disparate forms of personal injury are not typically funded.

Whether or not law firms can and should fill the gap remains to be seen as presumably the same drivers of risk and reward will apply to law firm decision making regarding whether to underwrite a class action as apply to funder decision making (although law firms taking instructions direct from class representatives may be better placed to make such assessments). As the VLRC notes there would be few law firms capable of financing large scale class actions in Australia without the assistance of litigation funders which often enjoy better access to capital markets. Likewise, experience from the United Kingdom indicates that the introduction of damages based fees has not led to any significant improvements in access to justice (although DBAs are not permitted for collective actions introduced for competition law claims). While DBAs are currently used only sparingly in the United Kingdom, it should also be noted that the sky hasn't fallen in since their introduction. As experience with DBAs in the United Kingdom matures broader uptake can be expected.

What might be some of the dangers of allowing law firms to charge contingency fees and are there sufficient safeguards in place to mitigate such risks? Drawing on US experience, some of the risks associated with allowing contingency fees for class actions have been outlined by John Coffee in his book *Entrepreneurial Litigation* (2015, Harvard Uni Press) as follows:

1. Settlements in some contexts (derivative actions, personal injury and mass torts actions) characterised by low market recovery for class members in exchange for above market rewards for class law firms
2. Multiple lawsuits in multiple US jurisdictions

Arguably both of these problems are of less concern in Australia and are not necessarily causally related to contingency fees. Professor Coffee's recommended solutions, for example, include:

1. The adoption of a mechanism for consolidating disputes across jurisdictions. To a limited extent, Australia has such a mechanism through the cross-vesting legislation.
2. Court appointment of class counsel. At this stage there is no pre-vetting of the class law firm and or class counsel in Australia. Arguably, implementation of such a power apropos the combination of class law firm and litigation funder is warranted as a result of the introduction of the common fund approach by *Money Max Int Pty Ltd v QBE Insurance Group Ltd* (2016) 245 FCR 191 (see above).
3. Partial certification to limit the effect of res judicata. Australia does not have pre-trial certification, but it is possible to exclude members or matters from the class settlement so as to limit the effect of res judicata and its extended form of issue estoppel and *Anshun* estoppel.
4. Implementation of adverse costs orders. Australia already has adverse costs orders which can extend to litigation financiers.
5. Refocussing securities class actions on corporate officers rather than the corporation to mitigate the impact of the action on 'innocent' shareholders.
6. Allowing regulators to recovery contingency fees to increase the volume of publicly directed class proceedings

Another scholar of note, Jonathan Molot,[1] has also forcefully argued that many of the problems associated with US contingency fees such as the pursuit of extortionate lawsuits of weak merit could be mitigated through the introduction of cost shifting, and to off-set risk averseness, market mechanisms like litigation financing. Since these measures are already in place in Australia there may be less concern that the implementation of contingency fees will lead to an 'avalanche' of US style class litigation.

Should the VLRC recommend the implementation of contingency fees there are many allied questions that will need to be considered. Some are listed below.

a. As financiers will lawyers be liable for adverse costs? Law firms are traditionally insulated from adverse costs orders, but arguably the logic of *Gore v Justice Corporation* (2002) 119 FCR 429 applies where the class law firm has a direct financial interest in the class compensation pool.
b. Will contingency fees only be recoverable when the Court approves the settlement (and hence implicitly or explicitly as above endorses the class law firm)? Should contingency fees associated with informal class action settlements be available outside of court processes and judicial scrutiny?
c. Should law firms be able to share their contingency fee risk with insurers (and is there a market for such insurance in Australia)? As financiers there is no reason why law firms should not be

[1] Jonathan Molot, 'Fee Shifting and the Free Market' (2013) 66 *Vand. L. Rev.* 1807

able to hedge their financial exposure to contingency fee risks and adverse costs (if applicable, see above). The question will be whether the cost of such insurance should be passed onto class members. Currently the cost of ATE insurance for adverse costs exposure is passed onto class members. But if the class law firm is acting on a generous contingency should the cost of their risk be then passed back to class members?

d. Will hybrid contingency fee + ordinary fees be permitted? For example, will law firms be able to charge a contingency fee up to a certain stage of proceedings and ordinary fees thereafter (eg for appeals, see below) or vice versa? If so, what should be the regulation of these arrangements, if any?

e. Will hybrid contingency fee + litigation funding arrangements be permitted? Such arrangements will increase price innovation and choice. For example, litigation funding may be sought for adverse costs exposure and disbursements but the class law firm may still charge a contingency fee for its work as currently occurs with conditional fee agreements.

f. What will be the permitted range of recoveries? Will there be a maximum threshold of 50% like the United Kingdom DBAs?

g. Will sliding scale recoveries be permitted/mandated? Australia's Productivity Commission (*Access to Justice Arrangements Inquiry Report*, 2014, Vol 2, pp 627 – 629) recommended the mandatory implementation of a sliding scale for contingency fees referring to overseas rates ranging from 10 – 40% (but these rates were not developed for class actions). Whatever the rate recommended, it is likely that contingency fees will be charged at the maximum allowed. Rather than use rates developed for other purposes, if the VLRC agreed with the Productivity Commission, it would be useful to examine actual rates charged in US class actions. These are outlined in Eisenberg, Theodore and Miller, Geoffrey P. and Germano, Roy, *Attorneys' Fees in Class Actions: 2009-2013* (December 1, 2016). NYU Law and Economics Research Paper No. 17-02; Cornell Legal Studies Research Paper No. 17-05. Available at SSRN: https://ssrn.com/abstract=2904194.

h. How should appeals be addressed? Presumably appeals would be dealt with in the usual way ie on a fee for service basis with the losing party liable for the costs of the appeal.

i. What is the position of a losing defendant vis-à-vis the contingency fee? A losing defendant is liable for a party's reasonably incurred costs. How will that work when the law firm charges a contingency fee? Will the losing defendant only be liable for costs that might have reasonably been incurred to conduct the proceedings and how will these be calculated (on a per hour basis working back from costs examination in comparable matters)?

j. How do contingency fees apply to compensation comprised of structured payments? Will the contingency fees be calculated on the net present value of future structured payments? If not, will the implementation of contingency fees deter structured payments? Are structured payments a feature of class actions anyway?