

IMF BENTHAM LIMITED

**Submission to the Victorian Law Reform Commission:
*Access to Justice – Litigation Funding and Group Proceedings***

6 October 2017

1. Introduction

- 1.1. IMF Bentham Limited (**IMF**) is pleased to make these submissions to the Victorian Law Reform Commission (**Commission**) on its inquiry into access to justice issues relating to the use of litigation funding, including for group proceedings (commonly known and referred to in these submissions as class actions). IMF has noted the focus of the terms of reference on access to justice and, in particular, on ensuring that litigants are not exposed to unfair risks or disproportionate cost burdens. IMF fully supports these objectives as its business involves facilitating access to justice for its funded clients.
- 1.2. In this introductory section, we have set out some background information about IMF, briefly addressed the importance of access to justice and included a summary of IMF's submissions. In section 2, we consider some of the policy issues relating to litigation funding and class actions and also address some of the misconceptions and incorrect assumptions about litigation funding that we respectfully submit are made in the Commission's Consultation Paper. Sections 3 to 8 of these submissions address some of the specific questions raised by the Commission in Chapters 3 to 8 of the Consultation Paper. In section 9, we conclude with a discussion about regulatory reforms that IMF submits are required, but which would apply to all Australian jurisdictions, not just in Victoria.
- 1.3. In these submissions, we have used the term litigation funder to refer to a third-party commercial litigation funder, as defined in the glossary to the Consultation Paper, and not to an insurer or lawyer acting on a no-win no-fee basis, even though insurers and lawyers are important sources of funding for litigation. The questions raised by the Commission are highlighted as boxed headings in this submission. IMF's answers are from the perspective as a funder but also from a sophisticated and repeat user of the civil justice system on the claimant's side.

Background – IMF Bentham Limited

- 1.4. IMF is Australia's largest and most experienced litigation funder. It listed on the Australian Securities Exchange (**ASX**) in 2001, specifically to promote transparency in what was at that time a new industry. In Australia, IMF operates from offices in Sydney, Perth, Melbourne, Brisbane and Adelaide. It commenced its business in Australia but was a pioneer of the global litigation funding industry and, through its subsidiaries, now has offices in the United States, Canada and Singapore.
- 1.5. IMF has a current market capitalisation of around \$349 million. In the 16 years since listing on the ASX, IMF has completed over 162 cases (excluding withdrawals), with an average case duration of 2.6 years. Of those 162 cases, 133 were settled, 14 went to judgment or on appeal

and were won and 15 were lost. From those results, total recoveries (settlements, damages and costs) have been \$2.1 billion, out of which we have returned over \$1.3 billion (62%) to funded claimants. Of the revenue received by IMF, \$306 million (15%) comprised reimbursement of the legal costs and disbursements paid by IMF to fund the claims, and \$486 million (23%) comprised IMF's net income (excluding overheads).¹

1.6. Funded cases currently under management are both large and small and have a total portfolio value in excess of \$3.7 billion, across a range of disciplines and jurisdictions². Further information on IMF can be found on its website at www.imf.com.au including its latest financial results in its Annual Report to Shareholders.

1.7. IMF funds a wide range of claims including:

- (a) single party disputes which include general commercial disputes, claims against estates and trustees, building and construction disputes, patents, professional indemnity claims, contract disputes, family law claims and claims against insurers;
- (b) multi-party litigation, including securities class actions, cartel claims, claims involving the provision of financial services and claims against the Commonwealth Government (Department of Defence) in connection with land contamination;
- (c) insolvency proceedings, including claims for insolvent trading, preferences and breach of directors' duties; and
- (d) international commercial arbitration and investment treaty claims.

1.8. In the claims that it funds, IMF provides funding for the claimants' own legal fees and disbursements (including counsels' fees, witness expenses and court costs), agrees to pay any adverse costs orders, in the event that the claims are unsuccessful, and will supply any security for costs that the court may order IMF's clients to provide. In return for IMF's promise of funding, claimants assign to IMF a share of any damages or settlement proceeds that are recovered from the opposing parties to their claims. The assignment includes reimbursement of all amounts IMF has paid and a percentage of the recoveries (typically in a range of 25 – 40% depending on the claim size, potential resolution sum, expected duration to resolution and risks undertaken).

1.9. IMF is paid nothing if the claims are unsuccessful. As IMF stands behind its clients' potential financial obligations to defendants, IMF normally agrees to pay any adverse costs orders in

¹ This data has been reviewed by Ernst & Young to 30 June 2017.

² In addition to funding litigation in Australia, the US, Canada and Singapore, IMF is funding or has funded litigation in New Zealand, Hong Kong, the United Kingdom, the Netherlands and South Africa.

respect of costs incurred during the term of the funding agreement³.

1.10. In addition to funding, IMF provides other services to its clients. These include investigating the claims and the prospects of them being resolved by means other than litigation (such as by direct negotiation with the defendant or through alternative dispute resolution, such as mediation or expert determination). In funded class actions, IMF plays a key role in locating potential claimants and informing them of the opportunity to join the class action to enforce their rights. IMF also manages the litigation, negotiates litigation budgets with the claimants' lawyers, ensures so far as possible that the legal costs and strategies are proportionate to the sums at stake, and gives instructions to the lawyers on a day-to-day basis (subject always to the claimants' rights to override IMF's instructions and the lawyers' paramount professional duties to the claimants). IMF also assists the claimants on litigation strategy and attends and participates in settlement discussions.

The importance of access to justice

1.11. In recent years, the high costs of litigation and lack of public legal funding have led to even greater issues for both individuals and companies in affording access to the civil justice system. The significant costs for a litigant in funding its own legal costs and disbursements, plus the risk of adverse costs orders if the litigation is unsuccessful, deter many individuals and companies from commencing litigation, even where they have a strong case. These costs and risks are serious barriers to access to justice and to the effective civil enforcement of Australia's laws.

1.12. This is a particular issue in relation to class actions which are particularly expensive and risky. Class actions funded by claimants themselves are rare, and few law firms have the financial capacity to conduct a large and lengthy class action on a 'no win, no fee' basis.⁴

1.13. In the High Court decision of *Campbells Cash and Carry Pty Limited v Fostif Pty Limited* (2006) 229 CLR 386 (**Fostif**), which confirmed that litigation funding was not contrary to public policy, Kirby J referred to access to justice:

"as a fundamental human right which ought to be readily available to all".⁵

1.14. The growth of the litigation funding industry in Australia (and globally) has been a private market response to the demand for increased access to justice in a time of rising legal costs and falling public funding.

³ The issue of ensuring that litigation funders have adequate capital is addressed in section 9 below.

⁴ See Consultation Paper, paragraph 2.81

⁵ At page 451.

- 1.15. The Law Council of Australia and the Federal Court of Australia, in their *Case Management Handbook* (July 2014), observed:

*"In many senses, litigation funding has proven to be the lifeblood of much of Australia's representative proceeding litigation at federal and state level. Not all cases are funded by third-party litigation funders but a sufficiently large number of class actions have been funded in this manner that it has had a major impact on the sorts of cases being conducted... This is a consequence of the time, cost and complexity of most representative proceedings and the risk burden, carried by the representative applicant, of an adverse costs order."*⁶

- 1.16. Lord Neuberger, then President of the UK's highest court, the Supreme Court, observed (extra-judicially)⁷:

"...as long as litigation, access to the courts, remains expensive, then anyone who has a right that stands in need of vindication should be able to obtain funding from anyone willing to offer it on whatever terms it is offered. The public policy rationale is simple in his opinion: access to the courts is a right, and the State should not stand in the way of individuals availing themselves of that right."

- 1.17. In its 2014 Report, which focussed on access to justice arrangements in the Australian civil justice system, the Productivity Commission stated that:

*"Litigation funding can promote access to justice by providing finance for the prosecution of genuine claims by claimants who would otherwise lack the resources to proceed."*⁸

- 1.18. IMF has built its business around meeting some of the demand for funding from claimants with strong legal claims who lack the financial resources necessary to pursue their claims through the civil justice system. IMF has made access to justice a practical reality for those claimants. To date, IMF has assisted over 130,000 claimants, from the largest investment funds to small businesses and individuals⁹.

- 1.19. Strong access to justice in a society increases the likelihood that laws will be enforced, wrongdoing deterred and losses due to misconduct adequately compensated by the wrongdoers. This is particularly important in relation to laws designed to protect the interests of consumers or promote confidence in the integrity of financial markets, due to the widespread

⁶ Law Council of Australia/Federal Court of Australia, *Case Management Handbook*, July 2014 at [13.12].

⁷ Lord Neuberger, *From Barretrie, Maintenance and Champerty to Litigation Funding*, Harbour Litigation Funding First Annual Lecture, Gray's Inn, 8 May 2013, at [46]. Lord Neuberger referred to funding (from all sources) as the "life-blood of the justice system". See also the report by Lord Justice Jackson (a Judge of the Court of Appeal of England & Wales) after his year-long review of civil litigation costs in which he gave significant support to third-party funding of litigation, which he viewed as promoting access to justice. He stated "it was better for [a claimant] to recover a substantial part of his damages than nothing at all" at Chapter 11, *Review of Civil Litigation Costs: Final Report (January 2010)*.

⁸ *Access to Justice Arrangements*, Inquiry Report No 72, at page 607.

⁹ IMF'S clients include private individuals, small businesses, superannuation funds and other institutional investors, churches, councils and charities and insolvency practitioners.

economic and social importance of those laws. Often, the only practical means of enforcing those laws is through a funded class action because individual losses are too small to justify pursuing alone. IMF's funding of class actions has facilitated the enforcement of a range of Australian laws including the continuous disclosure regime and trade practices, insolvency, financial services and competition laws¹⁰.

1.20. Litigation funding has another important benefit in that it can "level the playing field". A claimant with limited resources, whether an individual or company, is able to take on a larger defendant with (essentially) unlimited resources. The defendant will appreciate that an experienced, independent and objective commercial entity considers the claim to be of sufficient strength to merit funding and that the claimants cannot be 'outspent' or worn down in a lengthy war of attrition. This increases the prospects of a fair and just outcome in the proceedings.

Summary of IMF's submissions

In summary, IMF submits as follows:

- The Victorian class action regime largely works well. The Victorian Supreme Court has significant experience in overseeing very large class actions and the case law is constantly developing.
- Each class action involves different circumstances, considerations and issues. It is important for the Courts to have the flexibility to respond appropriately and to determine the issues on a case-by-case basis.
- There are parts of the Federal Court Practice Note that could usefully be adopted in the Victorian Supreme Court Practice Note for class actions.
- For example, disclosure of funding arrangements is appropriate in funded class actions (subject to the right to redact certain information). However, in IMF's respectful submission, equal disclosure obligations could be imposed on both plaintiffs and defendants where any form of external funding is involved for either party.
- In relation to the regulation of Victorian proceedings (not just class actions), both funded and unfunded, IMF's view is that the current system largely works well. However, the

¹⁰ See S H Lim, *Do litigation funders add value to corporate governance in Australia?* (2011) 29 C & SLJ 135 at page 146: "As litigation funders are focused on maximising their returns on investments, they also have strong incentives to monitor corporate disclosures, share price movements and regulator inquiries in order to identify litigation that has the best prospects of success. Thus, litigation funders are acting as private enforcers of statutory causes of action as well as providing individual shareholders with the means and incentives to monitor corporate conduct."

introduction of costs budgeting in all proceedings should be investigated for the purpose of introducing a procedure to enable the courts to manage the exposure of litigants to the risks and burdens associated with disproportionate costs in both funded and unfunded class actions in particular.

- IMF also proposes the establishment of a Supreme Court Class Action Users Group which includes a funder representative.
- The current system would be improved by further regulation of litigation funders at the Commonwealth level, particularly in relation to capital adequacy.
- A litigation funder operating at arm's length to the lawyers retained by the claimants is more beneficial for clients and subject to less risks than lawyers charging contingency fees. Lifting the ban on contingency fees would not mitigate but, on the contrary, would be likely to increase the conflicts issues that can arise in the funding of litigation.
- If the ban on contingency fees was to be lifted, lawyers who wished to act on this basis must be subject to the same potential liability to pay adverse costs as litigation funders.

2. Policy context

2.1. We have set out in this section some comments in response to the overview of the policy context contained in Chapter 2 of the Consultation Paper. We also address some misconceptions and incorrect assumptions that IMF respectfully submits are made about litigation funding in the Consultation Paper.

2.2. In IMF's submission, many of the criticisms that are made about litigation funding are unfounded, contradictory and inconsistent with the evidence. IMF submits that there is one important exception where reform of the Australian litigation funding industry is required and that is in relation to capital adequacy. IMF has long supported further regulation of funders, particularly given the recent growth of the funding industry, including the entry into the Australian market of overseas-based funders, and the increasing use of after the event insurance policies that do not adequately protect claimants from adverse cost risks. This is discussed at sections 3 and 9 below.

2.3. Chapter 2 of the Consultation Paper referred to the Productivity Commission's conclusion, following its review of access to justice arrangements, that "*litigation funding promotes access to justice, and is particularly important in the context of class actions*". However, the Consultation Paper also stated that "*from a public policy perspective there are significant*

limitations to the extent to which access to justice is served by litigation funding”, in particular due to funders’ case selection and the size of funding fees.¹¹ We address both of these issues below.

Case selection

- 2.4. The Consultation Paper referred to the “narrow variety of cases” that are funded, namely actions that seek redress for investors and shareholders, and stated that:

“As a consequence, the contribution that litigation funding makes to access to justice is limited...”¹²

- 2.5. IMF acknowledges that many of the class actions that have been funded by litigation funders to date are actions brought on behalf of shareholders and investors. However, litigation funders have also funded many other types of class actions, for example, cartel claims, consumer protection claims, mass tort claims including actions for property damage, actions on behalf of employees, franchisees, agents and/or distributors, and racial discrimination claims¹³. Outside class actions, litigation funders fund a range of actions from insolvency claims, seeking returns for creditors, to family law matters, as noted above.
- 2.6. IMF disputes the assertion that the types of cases that funders select to fund limits the contribution that litigation funding has made, and continues to make, to access to justice. Each funded case is of importance to the claimants involved. For example, the type of institutions that join shareholder class actions are often managed funds, large superannuation trustees or nominee companies for numerous investors. These institutions do not have a mandate or separate financing to pursue claims for loss or damage suffered by their clients. Prior to the emergence of litigation funding, these institutions rarely, if ever, commenced litigation or joined class actions. If and when class actions are settled or proceed to judgment and money flows to these institutions, the money is either attributed to the members’ funds or is distributed to the individual members. The actual number of direct and indirect clients of IMF is consequently a multiple of the 130,000 figure referred to above.
- 2.7. Both paragraphs 1.45 and 2.84 of the Consultation Paper state that litigation funders invest in claims that are low risk. In IMF’s view, this misconceives what funders mean when they say they only fund cases that have merit. This rarely, if ever, means the cases are low risk, although they should by definition be less risky than cases with minimal merit. There is significant risk in all litigation and particularly in the large actions funded by litigation funders.

¹¹ See Consultation Paper, paragraphs 2.80 to 2.84.

¹² Consultation Paper, paragraphs 2.89 and 2.91.

¹³ Professor Vince Morabito, *An Empirical Study of Australia’s Class Action Regimes, Fifth Report: The First Twenty-Five Years of Class Actions in Australia*, July 2017, at page 27.

- 2.8. It is also suggested that litigation funders select cases for the benefit of investors rather than cases for vulnerable people or “which are complex and likely to be costly and risky to prosecute” which, it is claimed, are conducted by law firms on a ‘no-win, no-fee’ basis or with funding support from government or the community. The class actions that litigation funders support are large, costly and complex. No class action is a simple proceeding that is low risk. It is true that litigation funders are seeking a commercial return from litigation funding. However, litigation funders do not only select cases that favour investors¹⁴. For example, IMF has conducted class actions for property owners affected by flooding and contamination and for consumers subjected to particular bank fees.
- 2.9. No system of funding for litigation anywhere in the world, whether publicly or privately funded, accepts (or can accept) all cases brought to it. Commercial litigation funders are for-profit entities and they must be satisfied that the potential rewards of providing funding for a particular class action outweigh the very substantial risks involved. Most litigation funders undertake thorough due diligence and have stringent criteria by which they assesses claims for funding. Rigorous case selection ensures that most cases that are funded have strong prospects of success and the Courts’ resources are not wasted on unmeritorious claims. The result of this careful selection is that most funded class actions result in a substantial settlement for the benefit of class members, many who would have received no return, but for the involvement of the funder.

Costs and funders fees

- 2.10. The Consultation Paper raised concerns about the costs of funded litigation. These concerns are primarily focussed on the size of the litigation funding fee, and whether it is aligned to the risks undertaken by the funder, as well as the proportion and transparency of the legal costs and funding fee¹⁵.
- 2.11. As set out in paragraph 1.5 above, in the 16 years since IMF listed on the ASX, IMF’s net income (excluding overheads) has been 23% of the total recoveries and 15% was for reimbursement of the costs paid by IMF to fund the claims. The majority of the recoveries, namely 62%, has been returned to IMF’s funded claimants¹⁶. IMF seeks only to fund claims with strong prospects that can be prosecuted at a proportionate cost. On the whole, our cases are successfully resolved. However, all litigation carries the risk of being lost or of costs substantially exceeding their estimates made at the outset. In some cases, IMF and the lawyers may agree to reduce their share of the ultimate recovery in favour of the claimants, but it must

¹⁴ As at May 2017, IMF had funded approximately 55 class actions, of which 27 concerned shareholder claims.

¹⁵ Consultation Paper, paragraphs 2.93 to 2.94.

¹⁶ This data has been reviewed by Ernst & Young to 30 June 2017.

be recognised that not all cases result in optimal outcomes.

- 2.12. IMF's funded clients are all aware of the funding fees when they enter into a Litigation Funding Agreement with IMF. As set out above, the funding fee is usually a percentage of the recoveries (typically in a range of 25 – 40%, depending on the claim size, resolution sum, expected duration to resolution and risks undertaken). In some cases, the fee is based on a multiple of the costs expended by the funder in the proceedings. Setting a funding fee is a complex commercial exercise and is often done on a portfolio investment approach and not just by reference to the particular case in question. A funder will need to generate enough revenue from its wins to cover the losses in its portfolio as well as operating costs.¹⁷
- 2.13. As the plurality (Gummow, Hayne and Crennan JJ) observed in *Fostif*¹⁸, the Court does not have a role in assessing whether a litigation funding agreement is “fair” as this wrongly assumes that “*there is some ascertainable objective standard against which fairness is to be measured and that the courts should exercise some (unidentified) power to relieve persons of full age and capacity from bargains otherwise untainted by infirmity.*”
- 2.14. The issue of costs and funders fees are addressed in more detail in response to the questions raised in Chapters 3 and 7.

Controversial class actions

- 2.15. As the Commission noted in the Consultation Paper, the following recent class actions have attracted negative media attention¹⁹:

- Great Southern, in respect of settlement approval;
- Kilmore bushfire class action, in respect of tax on settlement money interest;
- Murrindindi-Marysville bushfire class action, in respect of settlement distribution; and
- Huon Corporation²⁰, in respect of the costs and funder's fee taking up the whole of the recovery.

Two other cases that have also attracted controversy recently are the Timbercorp²¹ and Willmott Forests²² class actions.

¹⁷ Beach J considered the funder's portfolio as one of the grounds he took into account when considering the reasonableness of the funding commission rate in *Blairgowrie Trading Ltd v Allco Finance Group Ltd (Receivers & Managers Appointed) (In Liq) (No 3)* [2017] FCA 330 at [145].

¹⁸ At page 434.

¹⁹ See Consultation Paper, paragraph 1.12.

²⁰ *Fitzgerald v CBL Insurance Ltd* [2014] VSC 493 (**Huon Corporation**).

²¹ *Timbercorp Finance Pty Ltd (in liq) v Collins; Timbercorp Finance Pty Ltd (In Liq) v Tomes* [2016] HCA 44 (**Timbercorp**).

²² *Kelly v Willmott Forests Limited (In Liq) (No 4)* [2016] FCA 323 (**Willmott Forests**).

2.16. Given the focus of the terms of reference and Consultation Paper on litigation funding, it would have been fair to assume that these cases had all been funded class actions. However, of these six actions, only one was funded by a litigation funder, namely the Huon Corporation case. That case was not a class action, but an action brought by trustees on behalf of many former employees of Huon Corporation. The other actions were conducted by plaintiff law firms through raising contributions from class members (such as in the Great Southern and Willmott Forests class actions) or on a no-win no-fee (or conditional) basis.

Conditional costs agreements with law firms

2.17. These arrangements are discussed in paragraphs 2.20 to 2.24 of the Consultation Paper. However, there is no discussion about the controversial results in some recent class actions funded on a no-win no-fee basis or by the lawyers raising contributions from class members (as set out in paragraph 2.16 above). The issues that have arisen in these cases are addressed in more detail in response to question 3 below.

After the event insurance

2.18. After the event insurance is discussed in paragraphs 2.25 to 2.29 of the Consultation Paper, including a reference to its increasing use in Australia to complement a conditional costs agreement with a lawyer or litigation funding. The Consultation Paper also stated that “[i]n either case, the plaintiff bears no risk”. However, the plaintiff may bear a risk where the after the event insurance policy only provides cover for adverse costs up to a limit (and the adverse costs payable exceed that limit), if a question arises over the insurer’s right to deny indemnity or where the insurer’s ability to pay is impaired.

2.19. The recent decision in *Petersen Superannuation Fund Pty Ltd v Bank of Queensland Limited*²³ revealed the sort of risks that can exist under an after the event insurance policy. Justice Yates considered the policy in question did not provide sufficient security for a number of reasons including that the policy contained a number of exclusions, such as the entitlement of the insurer to reduce its liability or even cancel the policy on the basis of non-fraudulent non-disclosure (at [114 – [115]), the potential difficulties for the defendants in enforcing the policy (at [108] - [113]) and the risk as to whether the insurance proceeds would be available if the plaintiff was placed in liquidation ([at 125]). His Honour noted (at [26]) that the financial position of the litigation funder in that case was also largely unknown and there was no evidence it had any assets in Australia²⁴.

²³ [2017] FCA 699.

²⁴ The issue of ensuring that litigation funders have capital adequacy is addressed in section 9 below.

Actions brought for the benefit of vulnerable people

2.20. Paragraph 2.112 of the Consultation Paper referred to an article written by Jarrah Ekstein of Maurice Blackburn and Professor Vince Morabito which analysed 87 class actions filed in Australia for vulnerable people up to 2014, none of which had involved litigation funders. The implication from this statement is that funders do not do any pro bono work. IMF has provided pro bono assistance to matters. Although IMF is a for-profit company and has an obligation to its shareholders, it has, for example, provided financial assistance and adverse cost indemnities for individuals who have made discrimination claims, such as racial and disability discrimination claims. As set out on its website, IMF has a Corporate Social Responsibility programme and supports initiatives designed to make a real and positive contribution to the operation and effectiveness of the civil litigation process. Each supported initiative seeks, directly or indirectly, to provide greater access to justice.

3. Current regulation of litigation funders and lawyers

1. What changes, if any, need to be made to the class actions regime in Victoria to ensure that litigants are not exposed to unfair risks or disproportionate cost burdens?

3.1. As stated at paragraph 2.2 above and set out in more detail at section 9 below, IMF submits there is a need for greater regulation, in particular relating to capital adequacy, for all litigation funders operating in Australia. However, as noted in the Consultation Paper, this is an issue which requires reform at the Commonwealth level and is discussed in more detail in section 9 of these submissions.

3.2. In relation to the Victorian class action regime, IMF's view is that it largely works well. However, as indicated in our responses to questions 8 and 10 below, IMF submits there are parts of the Federal Court practice note that could usefully be adopted in the Victorian Supreme Court practice note for class actions²⁵.

3.3. This question is focussed on ensuring that class action litigants are not exposed to unfair risks or disproportionate cost burdens. In this section, we have proposed that the introduction of costs budgeting should be considered in all Victorian proceedings and we have also addressed some of the issues set out in the Consultation Paper in relation to the risks and costs of funded proceedings.

²⁵ Federal Court of Australia, *Class Actions Practice Note (GPN-CA) – General Practice Note*, 25 October 2016 and Supreme Court of Victoria, *Practice Note SC Gen 10 – Conduct of Group Proceedings (Class Actions)*, 30 January 2017 (**Federal Court Practice Note and Supreme Court Practice Note**, respectively).

Costs budgeting

- 3.4. Although the Consultation Paper does not raise specific questions about costs budgeting, it is addressed at paragraphs 6.104 to 6.109.
- 3.5. In IMF's submission, the introduction of a costs budgeting procedure, similar to the procedure that now exists in England and Wales under the Jackson reforms, should be investigated in not only class actions and proceedings involving litigation funders, but all proceedings²⁶. Under the Jackson reforms, cost budgets detailing a party's costs for each stage in the proceedings must be filed and exchanged between the parties prior to the first Case Management Conference. The parties consider each other's budgets and must also file an agreed budget discussion report before the first Case Management Conference, which sets out which figures in an opponent's budget are agreed, or not agreed and the grounds for dispute. The Court may make a "costs management order", recording the extent to which the budgets are agreed between the parties and record the Court's approval of a budget after making any necessary revisions²⁷.
- 3.6. If a costs management order is made, the Court will then control the parties' budgets in respect of recoverable costs. When assessing costs, the Court will have regard to a party's last approved or agreed budget and will not depart from it unless satisfied that there is good reason to do so. However, even where a costs management order has not been considered necessary, the Court may still take the budgets into account when assessing the reasonableness and proportionality of any costs claimed.²⁸
- 3.7. Each party is able to revise their budget if it is warranted by significant developments in the litigation and submit the budget to the other parties for agreement. Although the parties are able to amend their cost budgets to account for significant changes, the Court may not depart from a cost budget without good reason. As noted in the Consultation Paper, the Courts are able to limit the costs recovered by the successful party to the costs estimated in the budget. It is important that any reform contain the power for Courts to limit recovery, to ensure the reform has the effect of keeping costs down.
- 3.8. In IMF's submission to the Productivity Commission, IMF noted the difficult task of accurate budgeting and estimation of legal costs, particularly in large scale litigation. However, costs budgeting would introduce a procedure to enable the courts to manage the exposure of litigants

²⁶ See Consultation Paper, paragraph 6. 106. The costs budgeting regime applies to all 'Part 7 multi-track' claims with a value of less than £10 million in all English courts, including the Commercial Court (Herbert Smith Freehills, Litigation Notes, *Costs Management*, 13 February 2013 and *Costs Budgeting to be Extended to Cases below £10 million in all courts*, 26 February 2014).

²⁷ Herbert Smith Freehills, Litigation Notes, *Costs Management*, 13 February 2013.

²⁸ *Ibid.*

to the risks and burdens associated with disproportionate costs in both funded and unfunded class actions.

- 3.9. In a paper titled “Confronting Costs Management”, Lord Justice Jackson set out what he saw as the key benefits of the costs management measures²⁹:
- (a) parties know where they stand financially, as they have clarity as to what they will recover if they win and what they will pay if they lose;
 - (b) it encourages early settlement, as parties can see the total costs of the litigation and the extent of their own exposure;
 - (c) costs are controlled from an early stage;
 - (d) it focuses attention on costs at the outset of the litigation;
 - (e) case management conferences are more effective as the parties focus on what work is really necessary in light of the costs;
 - (f) it provides elementary fairness as it gives the other side notice of what you are claiming;
 - (g) it prevents legal catastrophes, as it protects losing parties from being destroyed by costs when they lose. This is in part because the Court also applies a test of proportionality when approving budgets.
- 3.10. In IMF’s submission, costs budgeting should be considered in light of the outcome of the Huon Corporation case. A key issue in the result of that matter was proportionality. Based on the judgment and news articles, it appears the claim in that proceeding (not including interest and costs) was for approximately \$4.8 million of insurance and the recovery on resolution was approximately \$5.1 million (including costs). The total proceeding costs (that is, lawyers, barristers, the trustees who brought the action and liquidators – not including the litigation funder) were approximately \$3.25 million³⁰. Accordingly, even before the funder’s fee is taken into account, these costs are arguably disproportionate to the size of the claim.

Disproportionate cost burdens

- 3.11. In IMF’s view, disproportionate costs to the size of any potential recovery are less likely to arise when a funder and/or lawyers have undertaken thorough due diligence and rigorous case

²⁹ Lord Justice Jackson, *Confronting Costs Management*, Harbour Lecture, 13 May 2015.

³⁰ Ben Butler, *Spotlight on legal fees as Huon workers miss out on \$5m payout*, The Australian, 26 August 2016.

selection, before agreeing to fund a class action. As set out in section 2, careful case selection ensures that most funded class actions result in a substantial settlement for the benefit of class members, many who would have received no return, but for the involvement of, and risks undertaken by, the funder.

Unfair risks

3.12. In IMF's submission, litigation funding by a commercial third-party funder mitigates many of the risks that are identified in the Consultation Paper.

Representative plaintiff's liability for adverse costs

3.13. One of the principal risks in class actions is the risk imposed on the representative plaintiff who may be exposed to liability for adverse costs in the event the class action is unsuccessful. This is a significant risk in large, complex class actions and is a structural disincentive to the bringing of a class action. The representative plaintiff takes on a large burden by being the named plaintiff in a class action and having to provide instructions to the lawyers on behalf of the class in the hearing of common issues.

3.14. Litigation funders play an important role in overcoming this barrier as a funder will usually bear the adverse costs risk, in addition to the representative plaintiff's costs. Even if the funder doesn't undertake a contractual obligation to pay, the Court has the power to make a non-party costs order against the funder if the case is lost. Although Part 4A³¹ provides that class members will not be subject to adverse costs orders in relation to the common issues³², in IMF's experience class members obtain a degree of comfort that, should the class action be unsuccessful, the defendant will be paid its final quantified adverse cost order by the litigation funder and there will not be a shortfall because, for instance, an after the event insurance policy put in place is capped, subject to an exclusion, or voided³³.

Conflicts of interest³⁴

3.15. Apart from costs risks, another principal risk for class members, identified in Chapter 3 of the Consultation Paper, relates to conflicts of interest that may arise in the tripartite relationship in funded proceedings between the litigation funder, the lawyers and the funded plaintiff. Paragraph 3.61 stated that:

"Conflicts of interest are particularly likely to arise within this relationship where:

³¹ Supreme Court Act 1986 (Vic) which provides for the procedures for class actions in Victoria.

³² Ibid section 33ZD.

³³ The issue of capital adequacy of litigation funders is dealt with at section 9 below.

³⁴ IMF has also addressed the issue of conflicts of interest in section 8 of these submissions, in the context of the proposal to lift the ban on lawyers charging contingency fees.

- *In a class action, the lawyers act for all class members, who have differing claims and needs which may conflict;*
- *There is a pre-existing legal or commercial relationship between the litigation funder and lawyers; and*
- *The funder has the control of, or the ability to control, the conduct of proceedings”.*

Lawyers acting for all class members

3.16. The first of these risks, which arises out of the fact that the lawyers act for all class members, is an issue in funded and non-funded proceedings alike. Balancing the interests and objectives of many different claimants is a fundamental challenge for lawyers that act in class action proceedings. Although the class members have claims that are sufficiently common to be brought as a class action through a representative plaintiff, class members’ individual circumstances and the strength of their claims may have differences. As class actions are generally managed as a two stage process, class members’ individual claims are determined only after the common issues have been heard and determined. The lawyers must conduct the class action in the best interests of all class members, whether they have signed a retainer with the lawyers or not³⁵.

3.17. In IMF’s submission, in funded proceedings some of the potential conflicts are mitigated by the involvement of the funder. For example, IMF’s objectives are closely aligned with those of the class members that it funds: namely to achieve the just, quick, inexpensive and efficient resolution of claims through appropriate use of the civil justice system and for the largest settlement or damages award possible having regard to the risks of the litigation. The funder’s involvement provides an important check and ensures there is oversight of the costs of the litigation which is for the benefit of all class members. The funder brings a commercial approach to the conduct and resolution of class actions that aligns closely with the interests of class members.

Legal or commercial relationship between the litigation funder and lawyer

3.18. The lawyers’ paramount duty to the Court and fundamental fiduciary duties to their clients ensures the focus in class action litigation is on the best interests of justice and on the clients. The lawyers are required to give priority to the instructions and interests of their clients, over the interests of the litigation funder. This is consistent with IMF’s funding agreements which expressly provide that, where the lawyer believes there is a conflict of interest between IMF and its funded claimants, the lawyer is to advise the claimants of their interests and eschew the

³⁵ See S Degeling and M Legg, Fiduciary Obligations of Lawyers in Australian Class Action: Conflicts between duties, UNSW Law Journal 37 (3) 914.

interests of IMF. Under the current system, whereby the lawyers are not permitted to charge contingency fees, the separation of the lawyer from the financing of the litigation, maintains the independence of the lawyer from the funder, enabling the lawyer to advise the client without the lawyer having any direct financial incentives in relation to the outcome of the case³⁶.

- 3.19. As set out in Chapter 3 of the Consultation Paper, all incorporated litigation funders are now subject to the Corporations Amendment Regulation 2012 (No 6) (**the Regulations**), which commenced on 12 July 2013, and ASIC's Regulatory Guide 248 (**ASIC's Regulatory Guide**) which together require litigation funders to maintain written procedures to effectively manage conflicts of interest which may arise in funded litigation.³⁷ The Regulations require a funder's procedures to deal explicitly with situations in which the lawyer acts for both the funder and the claimants (an unusual situation in IMF's experience, and one that doesn't apply in IMF's funded litigation). Generally, the lawyers act solely for the claimants. The Regulations also require procedures to manage situations in which there is a "pre-existing relationship" between the funder, the lawyers, the claimants or any of them³⁸.
- 3.20. In a market the size of Australia, it is inevitable that a funder may have previously funded litigation with a law firm which seeks funding from the funder for a new case. However, subject to the exceptions referred to in the following paragraph, IMF's experience is that funders and lawyers in Australia have historically operated on an arms-length basis. With increased competition, working relationships between lawyers and funders (and any expectation of future work) are unlikely to pressure lawyers to act in the interests of the funder in a way that conflicts with their duty to their clients.
- 3.21. Where there is an unacceptable legal or commercial relationship between the lawyers and the litigation funder, the Court is likely to use its inherent jurisdiction to restrain the lawyers from acting to ensure due administration of justice and to protect the integrity of the judicial process (*Bolitho v Banksia Securities Ltd* (No.4) [2014] VSC 582 and *Melbourne City Investments Pty Ltd v Treasury Wine Estates Ltd* (No 3) [2014] VSC 340)³⁹ or to permanently stay the proceeding for an abuse of process. The person that was restrained from acting in the above proceedings has also been at the centre of a number of class actions that were permanently stayed for abuse of process, on a similar basis and because the proceedings were brought for an improper purpose (*Treasury Wine Estates Limited v Melbourne City Investments Pty Ltd* [2014] VSCA 351; *Melbourne City Investments Pty Ltd v Leighton Holdings Ltd* [2015] VSCA

³⁶ For further details on the potential conflicts for lawyers charging contingency fees, see paragraphs 8.4 and 8.5 below.

³⁷ The explanatory statement to the Regulations (<http://www.comlaw.gov.au/Details/F2012L01549>) stated that: "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."

³⁸ See Regulation 7.6.01AB(4)(d)(vi). For a discussion of the conflicts regime, see the article by one of IMF's Senior Investment Managers Wayne Attrill, *The Regulation of Conflicts of Interest in Australian Litigation Funding*, (2013) *Journal of Civil Litigation and Practice* 193 and the chapter by Wayne Attrill, *The Future of Litigation Funding in Australia*, in M Legg (ed), *The Future of Dispute Resolution*, LexisNexis Butterworths (2013) at pages 177-178.

³⁹ See Consultation Paper, paragraphs 8.43 and 8.44.

235; *Melbourne City Investments Pty Ltd v Myer Holdings Limited* [2016] VSC 655; *Walsh v WorleyParsons Limited* [2017] VSC 292; and again (but in the Federal Court) in *Melbourne City Investments Pty Ltd v Treasury Wine Estates Limited* [2016] FCA 787).

3.22. However, in IMF's submission, it would not be appropriate to draw assumptions about the relationships or interaction of most lawyers and litigation funders on the basis of the actions of the individual at the centre of the above proceedings. Further, the Courts have shown that they have the powers and are prepared to use them when confronted with relationships between lawyers and funders or applicants that give rise to significant conflicts.

Litigation funder's ability to control proceedings

3.23. There is a well-established right of a funder to exercise influence and some degree of control over the day to day conduct of a funded action⁴⁰.

3.24. ASIC's Regulatory Guide provides an example where a funder might recommend to the lawyer that only certain causes of action should be pleaded⁴¹. In IMF's submission, it is difficult to see how claimants' interests could be detrimentally affected by a funder recommending that only the most promising causes of action are run in the interest of minimising the costs and risks of the proceedings and maximising the potential outcome.

3.25. There has long been concern that a funder might seek to force a settlement to advance its own interests. In respect of class actions, court approval of any settlement is required, which ameliorates the risk of any conflicts resulting in a settlement which is against the interests of class members. The Regulations also require funders' procedures to explicitly manage conflicts that might arise in settlement.

3.26. IMF's litigation funding agreements provide for disputes over settlement between IMF and funded claimants (or, in class actions, the representative plaintiff) to be resolved by means of a binding opinion given by the most senior counsel retained by the lawyers in the matter. IMF understands that other Australian funders also apply this approach which ASIC has recognised. ASIC's Regulatory Guide sets out a list of criteria that ASIC considers counsel should take into account in deciding whether any proposed settlement agreement is fair and reasonable⁴².

⁴⁰ The High Court's approval of litigation funding in *Fostif* occurred in a case in which the funder (not IMF) who, amongst other matters, organised and initiated the proceedings; gave all instructions to the solicitors in relation to the conduct of the proceedings; and had the power to settle the claims (provided the settlement was not less than 75% of the amount claimed). The Courts have also recognised the benefits a funder can bring to the efficient administration of justice (see *QPSX Limited v. Ericsson Australia Pty Limited (No. 3)* [2005] FCA 933, at [54]).

⁴¹ ASIC's Regulatory Guide 248.13.

⁴² See ASIC's Regulatory Guide at 248.94 – 248.98 and Wayne Attrill, *The Regulation of Conflicts of Interest in Australian Litigation Funding*, supra note 38.

3.27. The Regulations mean that all funders operating in Australia are subject to a common set of rules in relation to conflicts of interest. Under the Regulations, funders are required to not only adopt and implement a conflicts policy, but also to review it on a regular basis.

2. What changes, if any, need to be made to the regulation of proceedings in Victoria that are funded by litigation funders to ensure that litigants are not exposed to unfair risks or disproportionate cost burdens?

3.28. As stated above, IMF has long supported further regulation of litigation funders, particularly in relation to capital adequacy⁴³.

3.29. In relation to the regulation of Victorian proceedings, both funded and unfunded, IMF's view is that the system largely works well. However, in IMF's view, the introduction of a new costs budgeting procedure should be investigated for all proceedings⁴⁴.

3. Should different procedures apply to the supervision and management of class actions financed by litigation funders compared to those that are not?

3.30. In IMF's submission, there is no need for different procedures to apply to the supervision and management of class actions financed by litigation funders, compared to those that are not. As set out above, some of the recent class actions that attracted the most controversy (for example, Great Southern, Willmott Forests and the Bushfire class actions) were not funded by litigation funders, but were funded in other ways, such as on a no-win no-fee basis or by the lawyers raising funds from clients prepared to contribute. Some of the issues in these class actions arose from conflicts between the lawyer and the clients, and between those class members who contributed funds and those that did not contribute or register as a class member. The Great Southern, Willmott Forests and Bushfire class actions, that were not funded by (commercial) litigation funders, were also subject to significant issues around disclosure, adequacy of notices to class members, proportionality of legal costs and settlement approval.

3.31. In IMF's submission, the Courts have developed specialised practices and jurisprudence to efficiently manage class actions. These practices and principles already accommodate litigation funders and there is no need for any separate regime.

4. How can the Supreme Court be better supported in its role in supervising and managing class actions?

⁴³ See more detail in section 9 below.

⁴⁴ See paragraphs 3.4 to 3.10 above.

3.32. This question is addressed in response to question 8 and 10 below. IMF also proposes the establishment of a Supreme Court Class Action Users Group for the purpose of providing feedback to, and consultation with the Court on class action practices and procedure. IMF submits that, given the importance of litigation funding in facilitating the bringing of class actions in the Supreme Court, including a litigation funder in that group would be appropriate and representative of a significant stakeholder in the class actions procedure in the Court. IMF would be willing to participate in such a group.

5. Is there a need for guidelines for lawyers on their responsibilities to multiple class members in class actions? If so, what form should they take?

3.33. A number of the issues raised in the Consultation Paper regarding lawyers' conflicts of interest reflect the significant issues that arose in the Great Southern and Willmott Forests cases. The issues that arose regarding the lawyer's responsibilities to different groups of class members were unusual and also extensively addressed by the Court. In Willmott Forests, it resulted in a proposed settlement being rejected, at least in part because the proposed settlement was not fair as between group members.

3.34. IMF has no particular issue with the reform proposal that guidelines be drafted to assist lawyers to understand their duties to class members in class actions. However, IMF queries whether they are necessary when the duties should be clear to lawyers in any event.

3.35. In Willmott Forests, Murphy J stated⁴⁵:

"The applicant's lawyers owe fiduciary duties to class members who are their clients and they also owe duties to class members who are not their clients. These duties may or may not be fiduciary, but the applicant's lawyers at least have a duty to act in the class members' interests..."

And⁴⁶:

"Associate Professor Legg argues that, by reference to the established criteria, a fiduciary relationship exists between an applicant's lawyers and class members... Other authorities describe the applicant lawyer's duty as being to conduct the representative proceeding on behalf of the applicant in a way that is consistent with the interest of class members including those who are not clients..."

3.36. One of the reform options proposed in the Consultation Paper is that *"The Supreme Court could introduce practice requirements for litigation funders involved in class actions in relation*

⁴⁵ [2016] FCA 323 at [220].

⁴⁶ Ibid at [308].

to conflicts of interest.” In IMF’s submission, there is no need for practice requirements given the existing conflicts of interest regime with which all funders must comply.

4. Disclosure to plaintiffs

6. In funded class actions, should lawyers be expressly required to inform class members, and keep them informed, about litigation funding charges in addition to the existing obligation to disclose legal costs and disbursements? If so, how should this requirement be conveyed and enforced?

- 4.1. As part of their general obligations, lawyers should inform, and keep informed, class members (known to them) about all costs, cost estimates or basis for fees and charges, whether the class action is funded or not. This question refers to funded class actions only. However, as we have noted earlier in these submissions, some of the controversial class actions, which included problems in respect of disclosure and notices to class members, have been in proceedings conducted without the involvement of a litigation funder, such as Great Southern, Willmott Forests and the Bushfire proceedings’ settlement distribution schemes.
- 4.2. IMF’s practice in the class actions it funds is for prospective class members to be made aware of the litigation funding fees before they sign a funding agreement with IMF. IMF sends to these class members a copy of the proposed retainer agreement, the litigation funding agreement, a list of frequently asked questions and a disclosure document (which explains, among other things, the services IMF provides and identifies risks to claimants in funded litigation). These documents contain information about the likely legal costs and disbursements that are anticipated to be incurred and information about the funding fee, reimbursement of costs and any other charges that are payable to IMF in the event of success. If the proposed agreements (or a negotiated variation of them) are acceptable to potential class members, they will contract with the law firm and/or litigation funder to be part of the class action and the requirements set out in this question will be fulfilled with respect to those class members.
- 4.3. The lawyers should inform class members of the funder’s fees and charges as part of their duty to all class members to conduct the proceedings in their best interests. Costs information is also provided to class members in the event of any settlement of the class action for which Court approval is sought.
- 4.4. However, this question does not specify whether it applies to both “open” and “closed” class actions. In IMF’s view, compliance will be straightforward where class members are part of a closed class action (where the class is defined by the class members who have signed a funding agreement), which to date comprise the majority of the class actions funded by IMF. On the other hand, compliance with this requirement could raise difficulties where class members

are part of an open class action as the precise identity of and contact details for all persons in the class may not be known to the law firm and/or the litigation funder.

- 4.5. IMF submits that compliance in the case of an open class action would be more easily achieved if it includes a requirement that respondents make any data they hold on the identities of potential class members available to the applicant's solicitors and the funder. Alternatively, this requirement should only apply to the provision of the information to class members whose identity and contact details are known.

7. In funded proceedings other than class actions, should lawyers be expressly required to inform the plaintiff, and keep them informed, about litigation funding charges in addition to the existing obligation to disclose legal costs and disbursements? If so, how should this requirement be conveyed and enforced?

- 4.6. IMF would not object to lawyers being expressly required to inform the plaintiff about litigation funding charges. However, IMF submits that funded plaintiffs in proceedings other than class actions are informed about litigation funding charges through the litigation funding agreement they enter into, and the assistance in understanding the terms of the litigation funding agreement they ought already to receive from their lawyers (properly performing their duties), or from an independent lawyer. In funded actions that are not class actions, the lawyers have existing duties and contractual obligations, including fiduciary and statutory duties, to advise and keep the client informed about the action and the costs of the action.
- 4.7. When IMF funds proceedings other than class actions, it enters into a litigation funding agreement with the plaintiff client. The litigation funding agreement discloses information about the litigation funding fee (or commission) and reimbursement of costs and any other charges that may be payable to IMF in the event of success. IMF and the plaintiff enter into a litigation funding agreement after IMF has performed due diligence on the proposed claim and has made a funding proposal to the plaintiff. In all cases, IMF recommends that its prospective funded plaintiffs obtain independent legal advice as to the meaning and effect of its litigation funding agreements before entering into the litigation funding agreement. It is difficult to conceive of a situation in which a plaintiff would enter into a litigation funding agreement with a commercial funder without being aware of the litigation funding commission, the reimbursement of costs and any other charges payable to the litigation funder.
- 4.8. The plaintiff's lawyers are also aware of the litigation funding agreement and, in IMF's cases, are provided with a copy of it. The lawyers enter into their own agreement with IMF which obliges IMF to pay their costs. If the plaintiff does enter into the litigation funding agreement, the commission, costs reimbursement provisions and the basis for any other charges contained

in the litigation funding agreement could not be changed without a variation to the litigation funding agreement.

- 4.9. As set out above and in the Consultation Paper, litigation funders are regulated in relation to conflicts of interest at the Commonwealth level by the Regulations and ASIC's Regulatory Guide which apply to both single-party and multi-party funded proceedings.
- 4.10. As noted in the Consultation Paper⁴⁷, litigation funders are also subject to the consumer protections in the ASIC Act and are required to ensure the terms of their funding agreements are consistent with those consumer protections. The provisions contain protections against misleading and deceptive conduct, unconscionable conduct and unfair contract terms.
- 4.11. Given the application of the ASIC Act, combined with the lawyers' obligations, in IMF's view, further regulation with respect to lawyers' disclosure of litigation funding charges is unnecessary.

8. How could the form and content of notices and other communications with class members about progress, costs and possible outcomes be made clearer and more accessible?

Settlement and opt out notices

- 4.12. In IMF's view, the current requirements in the Supreme Court and Federal Court Practice Notes⁴⁸ for class actions are important to achieve sufficient disclosure and clarity, particularly in respect of two important notices, namely the opt out and settlement notices.
- 4.13. Both the Supreme Court and Federal Court Practice Notes set out requirements for what a notice of settlement to class member should contain, listing 16 and 17 items respectively. IMF submits that any prescription beyond what is currently in the Practice Notes is likely to be unhelpful. All class actions and settlements are different and the current requirements in the Practice Notes enable settlement notices to be tailored to the circumstances.
- 4.14. The Supreme Court and Federal Court Practice Notes also address the form of Opt Out notices. The Supreme Court Practice Note states that no opt out notice is to be given to group members without prior direction or order of the court and that the court may approve the form, content and manner of distribution of an opt out notice.

⁴⁷ Consultation Paper, paragraph 3.19 and see Division 2 of Part 2 of the ASIC Act.

⁴⁸ Supreme Court of Victoria, *Practice Note SC Gen 10 – Conduct of Group Proceedings (Class Actions)*, 30 January 2017 and Federal Court of Australia, *Class Actions Practice Note (GPN-CA) – General Practice Note*, 25 October 2016.

- 4.15. The Federal Court Practice Note goes a little further, setting out requirements for lawyers in preparing any opt out notices and also include a link to a sample form of an opt out notice. IMF submits that these requirements should be included in the Supreme Court Practice Note.
- 4.16. However, any attempt to further prescribe the content of the opt out and settlement notices may result in longer notices in which the disclosure is not tailored to the circumstances of the particular class action and/or which is confusing for class members.

Other notices and communications

- 4.17. IMF and the lawyers who act for the clients in the class actions that it funds, provide IMF's funded clients with regular updates about the progress of the class action proceeding. Most of the class actions IMF has conducted have been closed class actions and, accordingly, communication with a wider group is only necessary for those specific notices which are supervised by the Court.
- 4.18. In respect of communication with class members who are not clients of the litigation funder or the lawyers, it is important that lawyers appreciate their obligations are owed to all class members.
- 4.19. The lawyers' duty to conduct the proceeding in the interests of class members must include an obligation to provide as clear and adequate disclosure to class members as possible. The lawyers may also have to weigh the interests of class members to not publicly disclose information that may give the defendant a strategic advantage.
- 4.20. Paragraph 8 of the Supreme Court Practice Note (and paragraph 10 of the Federal Court Practice Note) provides that the Court may make orders concerning communications with class members who are not clients of the plaintiff's solicitors.
- 4.21. Again, any further prescription of the content of communications to class members may not assist, when those notices must be tailored to meet the circumstances of the particular class action. IMF submits that it is best to rely upon the supervisory role of the Court and its discretionary powers to make orders regarding notices and communications to the class in each particular case.

9. Is there a need for guidelines for lawyers on how and what they communicate with class members during a settlement distribution scheme? If so, what form should they take?

- 4.22. IMF has nothing to add in respect of this question.

5. Disclosure to the court

10. In funded class actions, should the plaintiff be required to disclose the funding agreement to the Court and/or other parties? If so, how should this requirement be conveyed and enforced?

5.1. In IMF's submission, disclosure of funding arrangements (subject to the right to redact any terms or information that is privileged or that might confer a tactical or strategic advantage on an opponent) is appropriate in all funded class actions⁴⁹. However, in IMF's respectful submission, equal disclosure obligations should be imposed on both plaintiffs and defendants where any form of external funding is involved for either party. This could include an after the event insurance policy, an employer or union funding the litigation, an insurer under a D&O or PI policy or otherwise. Disclosure of the identity of the "funder" (in this extended sense) and any relevant funding agreement or insurance policy should also be required.

5.2. These requirements should be introduced into the Supreme Court Practice Note.

11. In funded proceedings other than class actions, should the plaintiff disclose the funding agreement to the Court and/or other parties? If so, should this be at the Court's discretion or required in all proceedings?

5.3. In IMF's submission, the same requirement should apply to funded proceedings that are not class actions, namely equal disclosure should be imposed on both plaintiffs and defendants where any form of external funding is involved for either party. Again, all parties should be permitted to redact any information that might reasonably be expected to confer a tactical advantage on the other party (see paragraph 5.1 above).

12. In the absence of Commonwealth regulation relating to capital adequacy, how could the Court ensure a litigation funder can meet its financial obligations under the funding agreement?

5.4. In paragraph 5.16 of the Consultation Paper, the Commission noted that "[e]ven though disclosure is important... it is not a substitute for industry-wide regulation". As set out in section 9, IMF agrees with the Commission's view and has long called for further Commonwealth regulation, in particular relating to capital adequacy for all litigation funders operating in Australia.

5.5. IMF submits that the security for costs regime does not fully address the issue of ensuring that a funder has adequate funds to pay any shortfall between the security and any adverse cost orders that are made, and does nothing to address the funder's capacity to fund the plaintiff's costs of conducting the proceedings as provided in the funding agreement. In addition, where

⁴⁹ Federal Court Practice Note at paragraph 6.4.

security is provided in the form of an after the event insurance policy, there may be additional risks regarding adequacy, depending on the terms of the policy and the location and financial position of the insurer.

- 5.6. In the absence of Commonwealth regulation, as set out above, IMF proposes the establishment of a Supreme Court Class Action Users Group. IMF is willing to participate in such a group to develop specific rules or directions that help to ensure that a litigation funder can meet its financial obligations under each funding agreement.

6. Certification of class actions

13. Should the existing threshold criteria for commencing a class action be increased? If so, which one or more of the following reforms are appropriate?
- (a) introduction of a pre-commencement hearing to certify that certain preliminary criteria are met;
 - (b) legislative amendment of existing threshold requirements under section 33C of the Supreme Court Act 1986 (Vic);
 - (c) placing the onus on the plaintiff at the commencement of proceedings to prove that the threshold requirements under section 33C are met; and
 - (d) other reforms.

- 6.1. In IMF's submission, there is no empirical evidence or justification for the existing threshold criteria for commencing a class action to be increased. In IMF's view, increasing the existing threshold criteria by any of the proposed reforms or otherwise, would increase costs, likely delay the proceedings and limit, rather than enhance, class members' access to justice.

- 6.2. In IMF's view, where a proposed reform as significant as increasing the threshold criteria for class actions is considered, there should be empirical evidence of problems or issues with the existing regime from which reasoned arguments can be put in respect of any proposed reform. Paragraph 6.60 of the Consultation Paper merely referred to anecdotal information and paragraph 6.72 referred to one case in the Federal Court⁵⁰ as an example in which "decertification" proceedings⁵¹ were used as a basis for ruling it "*should no longer proceed as a class action, but only after it had already been running for years*". No explanation is given about

⁵⁰ *Pampered Paws Connection Pty Ltd v Pets Paradise Franchising (Qld) Pty Ltd (No 11)* [2013] FCA 241 (19 March 2013).

⁵¹ As discussed by Professor Vince Morabito and Jane Caruana in *Can Class Action Regimes Operate Satisfactorily without a Certification Device? Empirical Insights from the Federal Court of Australia*, (2013) 61 *American Journal of Comparative Law* 579.

why this occurred and whether it was a situation that could have been anticipated earlier in those proceedings or arose at a later stage due to unforeseen circumstances.

6.3. However, as noted at paragraph 6.73 of the Consultation Paper, Professor Vince Morabito and Jane Caruana of Monash University performed an evaluation based on empirical data collected on actions filed between 1992 and 2009 and found that *“the existing law and procedures do not appear to encourage lawyers to file cases not suited to class actions”*⁵².

6.4. Professor Morabito has recently discussed this evaluation and stated:

*“The data we collected revealed significant differences between the perceived operation of the regime and its actual operation. In fact we found no evidence of claimants taking advantage of this absence of a compulsory certification device by regularly filing class actions with respect to claims that could not possibly be advanced fairly and/or efficiently through the class action regime. **On the contrary, it was found that for every ten class actions that respondents sought to have judicially discontinued, eight proceeded as class actions, with the support of the court. It was also discovered that, contrary to popular belief, respondents had not filed decertification applications in a majority of class actions as almost three out of four Part IVA proceedings were not the subject of decertification applications.**”*

...
*The empirical data concerning the operation of this decertification regime, when it is activated by challenges launched by respondents, also revealed a different reality from that depicted in the legal literature. In fact, it showed that more often than not such challenges were dealt with more promptly than certification motions in the US.”*⁵³ [Emphasis added.]

6.5. In IMF’s respectful submission, and as Professor Morabito noted, it is important to distinguish between perceived and actual problems in the class action regime. Based on Professor Morabito and Ms Caruana’s analysis, the introduction of a certification process would not save time and money and would in fact cause delays. In IMF’s view, a formalised certification step would result in a mini-trial and, accordingly, this would be likely to impose significant additional costs and delays on plaintiffs in class actions, without any countervailing justification or conferring any certain benefit. Certification may also prevent the Court from managing issues and exercising its powers freely and efficiently, and tailoring its approach to the particular circumstances of the case.

6.6. In IMF’s submission, the cost-shifting or “loser pays” rule in Australia is a significant disincentive to plaintiffs commencing a class action without being able to meet the threshold criteria or one

⁵² Ibid at page 614.

⁵³ Professor Morabito, *Empirical Perspectives on 25 Years of Class Actions* in Damien Grave and Helen Mould (eds), *25 Years of Class Actions in Australia: 1992-2017*.

that is otherwise unmeritorious⁵⁴. This is in contrast with the United States where the loser pays rule does not apply. It would explain, in part, why a certification process may be more suitable in the United States.

- 6.7. The current approach, as set out in both the Supreme Court and Federal Court Practice Notes, is to provide for a first and subsequent case management conferences, at which the parties not only raise the issues and facts that appear to be in dispute, but are required to deal with any issues arising from the disclosure requirements, the description of class members, pleadings and security for costs. At the initial case management hearings, defendants are also able to raise the prospect of interlocutory applications they intend to make and, where there are competing class actions, the court can determine the process by which that issue is to be addressed.
- 6.8. Accordingly, and as noted in the Consultation Paper, a de-facto certification process or device is in place⁵⁵, but with the flexibility that enables the parties and the Court to focus on only the issues that arise in that particular proceeding. Such a process is more efficient due to its flexibility. Under the current regime, as noted at paragraphs 6.68 to 6.70 of the Consultation Paper, provisions such as sections 33N and 33ZF provide the Court with the powers and discretion to terminate proceedings as class actions where appropriate.

14. Should the onus be placed on the representative plaintiff to prove they can adequately represent class members? If so, how should this be implemented?
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- 6.9. IMF does not object to the introduction of guidelines relating to the choice of representative, provided the guidelines are developed in consultation with stakeholders, including litigation funders. However, in IMF's submission, there is no requirement for the onus to be placed on the representative plaintiff to prove they can adequately represent class member or for any reform in this area. There is no evidence, provided in the Consultation Paper or elsewhere, that there is a problem with representatives not being adequate to the task of representing class members or sufficiently engaged in their role. Nor is there any evidence that the current regime, including sections 33Q (Where not all questions are common and appointment of sub-groups), 33R (Individual questions), 33S (Directions for further proceedings), 33T (Adequacy of Representation) and s 33ZF (General power) of the Supreme Court Act 1986 (Vic), is inadequate in this respect⁵⁶.
- 6.10. In IMF's view, introducing a further threshold or legislative hurdle for representative plaintiffs in class actions would only increase costs and accordingly reduce access to justice.

⁵⁴ It should be noted that lawyers in Victoria are required to certify that any action has a proper basis for commencement under section 42 of the Civil Procedure Act 2010 (Vic).

⁵⁵ See Consultation Paper, paragraph 6.3.

⁵⁶ See also the discussion by Beach J in *Earglow Pty Ltd v Newcrest Mining Ltd* [2015] FCA 328 with respect to the parallel provisions in the Federal Court Act.

15. Should a specific legislative power be drafted to set out how the Court should proceed where competing class actions arise? If not, is some other reform necessary in the way competing class actions are addressed?

6.11. In IMF's submission, there is no need for a specific legislative power to be drafted that sets out how the Court should proceed where competing class actions arise.

6.12. In the recent decision in *McKay Super Solutions Pty Ltd (Trustee) v Bellamy's Australia Limited*⁵⁷ (**McKay Super Solutions**), Beach J extensively considered the available options for dealing with two competing open class actions that had been commenced in respect of the same alleged wrongdoing. His Honour began by eliminating a number of available options, namely to consolidate the two proceedings, make a declassing order in relation to one of the proceedings or do nothing. His Honour then weighed the remaining available two options, to permanently stay one of the proceedings or close the class of one proceeding, leaving the other class open and have a joint trial of both.

6.13. In IMF's view, Beach J's analysis and decision, based on the variety of issues and circumstances that were present in respect of the two competing class actions, not only revealed the adequacy of the powers of the Court under the existing regime, but also the importance of maintaining the Court's flexibility in dealing with competing class actions.

6.14. In respect of adopting the approach taken in the United States, Beach J stated⁵⁸:

"It is difficult for US mechanisms to be carried across. First, in the US, choosing the representative applicant or what has been described as the class representative takes place in the context of a certification regime where permission to proceed is necessary, which is not the Part IVA context. Competition for the right to proceed is not directly comparable to the scenario where there is a prima facie right to proceed. Second, in the US, generally there is no adverse costs exposure; contrastingly, in Australia any competition for the class action and the associated bid economics will be affected by different risk pricing reflecting different risk perceptions. Third, institutional investors play a different role in class actions in the US than they do in Australia; the utility and dynamics of US committees may not be comparable. Fourth, I am faced with substantial numbers of group members in each of the proceedings who are the subject of litigation funding agreements with separate external funders. No similar context operates in the US. Moreover, any sealed bid process could now have no meaningful utility given the existence, magnitude and exposure of such contractual arrangements. Fifth, US-style

⁵⁷ [2017] FCA 947.

⁵⁸ *Ibid* at [23].

mechanisms proceed on the assumption that representative applicants are mere figureheads, a doubtful assumption on the evidence before me. Each of these matters demonstrates the difficulty of applying US mechanisms to the present problem. Finally, as Professor Vince Morabito has explained with his usual cogency in “Clashing Classes Down Under – Evaluating Australia’s Competing Class Actions through Empirical and Comparative Perspectives” (2012) 27 Connecticut Journal of International Law 245 at 301, even in the US it has been perceived that sealed bid auctions do not necessarily hold the answer to solving the problem of competing class actions.”

- 6.15. In IMF’s view, a legislative imposition of a US-style regime, to create a single class action where there are competing actions, will not necessarily extinguish all of the issues referred to by Justice Beach. Also, it may simply result in plaintiffs choosing different Australian jurisdictions to issue proceedings if the reform was not adopted nationally. Legislation prescribing both how competing class actions should be dealt with and the relevant considerations is likely to be too inflexible given the variety of issues that arise and the many different scenarios presented to the Courts.
- 6.16. In McKay Super Solutions, Beach J decided to close one class action and leave the other open, considered which was the preferable action for unsigned group members, and provided a “non-exhaustive” list of considerations that were relevant to that decision⁵⁹.
- 6.17. In IMF’s submission, flexible guidelines have begun to be developed in Australia through case law to deal with the issues of competing class actions. The Courts are already considering issues of efficiency, burden on defendants and the interests of all class members. There is no evidence that the Courts are failing to balance these issues when confronted with competing class actions.

16. Does the involvement of litigation funders in class actions require certain matters (and if so, which) to be addressed at the commencement of, or during, proceedings?
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- 6.18. As set out in section 5 above, IMF has submitted that disclosure should be made in class actions of any external funding arrangements (by both plaintiffs and defendants who are supported by any form of external funding).
- 6.19. As noted at paragraph 6.94 of the Consultation Paper, the Federal Court Practice Note contains some other specific requirements in relation to the involvement of litigation funders that should be considered in consultation with stakeholders. IMF would be happy to be part of such a process.

⁵⁹ Ibid at [71].

6.20. Paragraph 6.93 of the Consultation Paper refers to an argument (in one journal article) that the involvement of litigation funders increases the desirability of certification of class actions. As IMF has submitted above, a certification procedure would not only introduce additional costs compared to the existing flexible case management procedure, but could produce undesirable outcomes as seen in overseas jurisdictions, such as its transformation into a mini-trial and delays arising from appeals.

Certification relating to pleadings

6.21. In paragraph 6.100 of the Consultation Paper, certification is also proposed as a means by which to remove from class action plaintiffs the opportunity to refine their pleadings, either as a result of applications by the respondent or additional material becoming available to the plaintiff. In IMF's view, introducing certification to prevent pleading disputes would only add an unnecessary barrier and significant costs to plaintiffs and be likely to have the opposite effect of that desired by defendant lawyers. That is, the Courts would be likely to permit class actions to proceed on less refined pleadings as the Court would not want plaintiffs with good claims to be shut out due to pleading issues.

6.22. As noted at paragraph 1.49 of the Consultation Paper, although there are criticisms by defendants regarding the onus being on them to show why a class action should not continue, an alternative view is that "*applications are used as a tactic to avoid a trial and are not an unavoidable consequence of the current law*".

7. Settlement

17. How could the interests of unrepresented class members be better protected during settlement approval?
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7.1. In IMF's submission, the interests of unrepresented class members are adequately protected during settlement approval under the current regime. This is based on the protections in the legislation (*Supreme Court Act 1986 (Vic)* and *Civil Procedure Act 2010 (Vic)*), the Supreme Court Practice Note and case law.

7.2. Consequently, the Court must protect the interests of class members that have not signed a retainer with the representative plaintiff's lawyers or a funding agreement with the funder when approving a settlement.

7.3. It is also clear under the case law that the lawyers are required to protect the interests of class members that have not signed retainers or funding agreements. As Justice Murphy stated in

Willmott Forests⁶⁰, it is not the case that lawyers only have duties to those class members that have engaged the lawyers.

- 7.4. The Commission has identified one option for reform as being the appointment of a contradictor. In IMF's submission, the Court should retain the discretion whether or not to appoint a contradictor when it considers that it would be beneficial in the particular circumstances. In *Blairgowrie Trading Ltd v Allco Finance Group Ltd (Receivers & Managers Appointed) (In Liq) (No 3) (Allco)*⁶¹, settlement approval decision, Beach J stated⁶²:

"I should say that I have considered whether to appoint counsel as amicus curiae to assist me on these questions, but ultimately decided that the cost and delay involved would outweigh the potential benefits."

- 7.5. A good example of the circumstances in which the Court determined it would be assisted by the appointment of a contradictor due to the complexity of the issues between class members is Willmott Forests. Murphy J stated⁶³:

"In the present cases many class members retained the solicitor for the applicants, Macpherson and Kelly ("M+K") ("client class members") but the great majority did not ("non-client class members"). When the Notice of Proposed Settlement was before the Court for approval I noted that the settlements fell outside the pleaded case and I reached the view that counsel should be appointed as a contradictor to represent the interests of non-client class members...M+K provided the Contradictor with all necessary information, including confidential information, and I directed that the costs of his appointment be shared between the parties."

- 7.6. In IMF's view, because the appointment of a contradictor was appropriate in Willmott Forests does not mean a contradictor should be appointed in all settlement approvals. It should be considered on a case-by case basis. A contradictor would be an unnecessary additional cost in many settlement approvals, and particularly undesirable when the proportion of costs compared to the settlement sum is already high.

- 7.7. In particular, it is worth noting that Willmott Forests was an unusual case for a number of reasons including:

- (a) Willmott was not funded by a third-party litigation funder, but funded by some of M+K's clients;

⁶⁰ See paragraph 3.35 above.

⁶¹ [2017] FCA 330.

⁶² Ibid at [90].

⁶³ At [4].

- (b) some class members had made contributions to M+K's legal fees and disbursements and to the security for costs sought by the respondents;
- (c) as a result of an insufficient number of claimants being prepared to provide contributions for security for costs and a shortfall in the required security, to avoid the proceeding being stayed, Justice Murphy facilitated a class closure process to reduce the class to those persons who made a contribution or could prove they were unable to make a contribution (see [33]);
- (d) the result of the class closure was that there were three categories of claimant, those who opted out, those who registered (and generally contributed) and 'non-participating class members (who would remain class members and bound by a judgment or settlement, but not be able to seek relief or seek any benefit from a settlement) (see [38] – [46]);
- (e) the settlement terms agreed to by the lawyers included not just the dismissal of claims made on behalf of class members for misleading and unconscionable conduct, but also the giving up of class members' defences (including individual defences) to debt claims by some of the respondents against class members. The agricultural managed investment scheme class actions were unusual in that they were in one sense 'defensive' class actions;
- (f) Justice Murphy stated that at the time the registration and opt out notices were ordered, he had not apprehended a settlement in which the applicants would enter into binding loan enforceability admissions on behalf of the class members;
- (g) the registration and opt out notices failed to adequately disclose the potential consequences, including that class members might lose their defences to loan enforcement proceedings;
- (h) the proposed settlement (which effectively only covered part of the legal costs, disbursements and security for costs) benefited the clients of M+K that had contributed to those costs and delivered a detriment (loss of defences) without any benefit to class members that had not contributed; and
- (i) accordingly, the settlement terms that the lawyers were asking the Court to approve created a significant conflict in the lawyer's duty to their clients that had contributed to their fees and the other class members.

7.8. The result in Willmott Forests was that Justice Murphy refused to approve the settlement. Lawyers have a duty to conduct the proceedings in a way that is consistent with the interests of all class members (client or not). However, in IMF's view, under the current regime, the Court is well placed to protect class members' interests, even in the more unusual proceedings and settlement circumstances.

18. What improvements could be made to the way that legal costs are assessed in class actions?
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7.9. In IMF's respectful submission, it is important that legal costs are not forgotten as a significant factor to be addressed in the Commission's review of class actions and litigation funding.

7.10. As shown in the Great Southern and Willmott Forests class actions, in which there was no litigation funder involved, large legal fees can produce very disappointing results for class members whether or not there is also a funding fee. In fact, legal fees can exhaust the claim value in any commercial litigation, whether or not litigation funders are involved.

7.11. Further, whilst the Bushfire class actions produced very large settlement sums, some class members have since become upset, not only about the time taken for distribution of settlement sums, but also the size of the total legal costs⁶⁴.

7.12. Proportionality of costs to the claim value should be carefully considered prior to initiating proceedings and revisited during the conduct of the litigation. This is the case in circumstances where the costs comprise the lawyer's professional fees and disbursements, and when litigation financing costs are also included.

7.13. Some litigation funders, such as IMF, are active in managing legal costs and keeping lawyers to their budgets (acknowledging additional costs may arise due to unforeseen events in the litigation). Litigation funders will perform this role because it is in the interests of both the litigation funder and class members.

7.14. Further, where litigation funders are involved, the proportionality of the legal costs to the claim value should help participants determine whether litigation funding is performing a useful role, or whether it would be uncommercial for a litigation funder to be involved. For example, if the lawyers prepare a conservative costs budget that is in the range of 30 - 50% of the conservative claim value, and the funding fee is likely to fall within 25% - 40% range, it should be readily apparent that the class members may end up with a relatively small portion of the resolution sum.

⁶⁴ See Pia Akerman, *Angry survivor returns Black Saturday payout to 'only winner', Maurice Blackburn*, The Australian, 1 May 2017.

7.15. As proposed above, costs budgeting provides a means by which costs can be considered and assessed at the beginning of a matter, rather than at the end, after the costs have already been incurred. Costs budgeting would also assist the Court in providing a measure by which costs could be assessed at settlement.

19. Should the following matters be set out either in legislation or Court guidelines?

- (a) criteria to guide the Court when assessing the reasonableness of a funding fee;
- (b) criteria for the use of caps, limits, sliding scales or other methods when assessing funding fees; and
- (c) criteria or 'safeguards' for the use of common fund orders by the Court.

7.16. In IMF's submission, there is no need for any of the criteria proposed to be set out in legislation or Court guidelines. The current regime requires approval by the Court of any settlement and, as noted by the Commission in paragraph 7.6 of the Consultation Paper, each class action settlement involves different considerations, challenges and possible outcomes. It is important for the Court to have the flexibility to respond appropriately.

Assessing the reasonableness of a funding fee

7.17. As noted at paragraph 7.49 of the Consultation Paper and above, the High Court observed in *Fostif* that the Court does not have a role in assessing whether a litigation funding agreement is "fair" as this wrongly assumes that "*there is some ascertainable objective standard against which fairness is to be measured and that the courts should exercise some (unidentified) power to relieve persons of full age and capacity from bargains otherwise untainted by infirmity*"⁶⁵.

7.18. Under the current class actions regime, settlements are required to be approved by the Court. As part of that approval process, the Court will assess the reasonableness of any litigation funding fee and has the power to reject a settlement proposal due to the size of the fee. IMF's commission fees have repeatedly been approved by the Court in settlement approvals.

7.19. In IMF's view, while Justice Murphy in *Earglow Pty Ltd v Newcrest Mining Ltd*⁶⁶ and Justice Beach in *Allco* have expressed views regarding the Court modifying funding fees within that approval process, the position as to the source of any power to vary funding agreements

⁶⁵ Supra note 5, pages 434-5 at [92].

⁶⁶ [2016] FCA1433.

remains unresolved. Further, the observations of the High Court in *Fostif* (referred to above) have not been challenged⁶⁷.

7.20. In IMF's submission, regard must also be had to the principle expressed by the High Court in *Toll (FGCT) Pty Ltd v Alphapharm*⁶⁸:

"...where man signs a document knowing that it is a legal document relating to an interest in property, he is in general bound by the act of signature. Legal instruments of various kinds take their efficacy from signature or execution. Such instruments are often signed by people who have not read and understood all their terms, but who are nevertheless committed to those terms by the act of signature or execution. It is that commitment which enables third parties to assume the legal efficacy of the instrument. To undermine that assumption would cause serious mischief.

In most common law jurisdictions, and throughout Australia, legislation has been enacted in recent years to confer on courts a capacity to ameliorate in individual cases hardship caused by the strict application of legal principle to contractual relations. As a result, there is no reason to depart from principle, and every reason to adhere to it, in cases where such legislation does not apply, or is not invoked."

7.21. Importantly, as set out above, any assessment of the funding fee remains an aspect of the Court's role in the approval of class action settlements and should not be perceived as something performed in isolation from settlement approval. Guidelines already exist in the Supreme Court Practice Note for settlement approval⁶⁹.

7.22. In IMF's view, it is doubtful whether the Court would be assisted by guidelines beyond those that already exist. Reasonableness, by its very nature, is a question to be asked in the particular circumstances. Any criteria beyond the existing settlement approval guidelines would either be too narrow to cover the variety of matters relevant for the Court to consider, or too extensive to be of any utility. The relevant matters for the Court to consider will be apparent to the Court in light of the particular circumstances of the action, settlement terms, costs and funding arrangements⁷⁰.

⁶⁷ The Hon Justice M B J Lee, *Varying Funding Agreements and Freedom of Contract: Some Observations*, IMF Bentham Class Actions Research Initiative with UNSW Law: Resolving Class Actions Effectively and Fairly, 1 June 2017.

⁶⁸ (2004) 219 CLR 165 at pages 182-3.

⁶⁹ Supreme Court Practice Note at paragraphs 13.3 and 13.5 and in the Federal Court Practice Note at paragraphs 14.4 and 14.5.

⁷⁰ As set out at paragraph 2.12 above, setting a funding fee is a complex commercial exercise. It is often done on a portfolio investment approach and not just by reference to the particular case in question.

7.23. In IMF's submission, Beach J's consideration of the commission fee in the application for settlement approval and a common fund order in *Allco* revealed the level of "flexibility and nuance" required to be applied to the exercise. His Honour performed a comparative analysis of funding commissions in Australia and certain foreign jurisdictions and listed numerous matters that supported his view that the rate was reasonable⁷¹.

Use of caps, limits, sliding scales or other methods when assessing funding fees

7.24. When assessing the reasonableness of funding fees, caps, limits and sliding scales are unlikely to be helpful and may simply turn into the minimum standard rates. As set out above, the considerations of the circumstances of the case, and an assessment of the market, is not conducive to fixed or inflexible methods or structures. As Beach J stated in *Allco*⁷², the Court is well suited to the task of bringing flexibility and nuance to the assessment of the reasonableness of fees as compared with regulation under idiosyncratic State legislation. He stated⁷³:

"But valuable services such as that which a funder provides have a commercial cost and if it can be justified, so be it. It would be short-sighted to chill investment by importing into the analysis some form of asymmetrical social philosophy when to do so would be antithetical to the purpose of Part IVA which is to enhance access to justice, which is what litigation funders have objectively brought about, albeit motivated by self-interest. If any exercise of power under Part IVA is to be in the best interests of group members, it is not conducive to that objective to take a step that would unnecessarily chill a mechanism that group members may need to access the regime under Part IVA in the first place. To do so would be counterintuitive if not contradictory."

Criteria or safeguards for the use of common fund orders

7.25. IMF notes the recent trend toward the use of common fund orders. Common fund orders are a Court managed mechanism in which the Court is asked to set the funding fee and therefore provides for direct influence by the Court over the size of the fee. The aim of the common fund order, with the associated open class, is for access to justice to be enhanced⁷⁴. The common fund mechanism is intended to be more favourable or at least have the same effect to class members than alternatives such as the funding equalization mechanism. In IMF's view, the existing regime provides the Court with the powers and flexibility to make and manage these orders appropriately.

⁷¹ [2017] FCA 330 at [118] – [160]; see also footnote 17.

⁷² *Ibid* at [142].

⁷³ *Ibid* at [160].

⁷⁴ *Allco* at [106].

20. Is there a need for an independent expert to assist the Court in assessing funding fees? If so, how should the expert undertake this assessment?

7.26. The Federal Court Practice Note now provides that, in respect of settlement approvals, it will usually be sufficient that *“in relation to the litigation funding charges, an independent expert has examined the litigation funder's records in order to provide assurance to the Court that the litigation funding charges, as calculated, are appropriate having regard to the terms of the litigation funding agreement”*⁷⁵.

7.27. As set out at paragraph 7.78 of the Consultation Paper, the determination of reasonableness of the funding fee under the Federal Court Practice Note is dependent on the contractual arrangements entered into by the parties.

7.28. This question appears to propose the use of an expert for a different purpose, that is, more generally to assist the Court when it assesses the reasonableness of a funding fee for the purpose of approving a settlement.

7.29. In IMF's submission, the Court is best placed to determine when it requires an expert on a case-by-case basis and, if it does, it has the power to appoint an expert to assist. To place a mandatory requirement that an expert assist the Court, just as to require a contradictor, would create an unnecessary cost and reduce the flexibility of the current regime. In *Allco*, Justice Beach conducted a thorough analysis (including a comparative analysis of funding rates in foreign jurisdictions), without the assistance of an expert. As noted above, in the circumstances of that case, he considered, but rejected, the need to appoint counsel as *amicus curiae* to assist him in assessing the settlement for approval.

21. At which stage of proceedings should the Court assess the funding fee? What, if any, conditions should apply to this?

7.30. If the Court is assessing a funding fee, as part of its role of assessing a settlement approval application, then the Court can only assess the funding fee when it has that application before it.

7.31. In respect of a common fund order, it is a matter for the Court before which a common fund application has been made to determine when to assess the fee.

⁷⁵ Federal Court Practice Note at paragraph 15.2.

7.32. In *Blairgowrie Trading Ltd v Allco Finance Group Lt (Receivers & managers Appointed) (In Liq)*⁷⁶, the first Allco common fund application, Wigney J found that the common fund application was, at that stage, premature and ought properly be considered at a later stage of the proceedings when the facts were fully known⁷⁷ However, in IMF's view, this does not mean that applications for a common fund order must be made at settlement or later in the proceedings, including approval of the common fund funding rate. The Court must be able to consider applications on their merit and assess them in the circumstances and on the arguments presented to it.

7.33. If a Court is assessing the reasonableness of a funding fee, as part of a settlement approval or a common fund order, at the end or at a late stage in the proceedings, then there may be risks of hindsight bias. In IMF's submission, the Court is well equipped to understand the issue of hindsight bias in its role of assessing reasonableness. In *Money Max Int Pty Ltd (Trustee) v QBE Insurance Group Limited* [2016] FCAFC 148, when listing the relevant considerations a Court might have in determining a reasonable funding commission rate, the Full Court of the Federal Court included the following⁷⁸:

"(d) the litigation risks of providing funding in the proceeding. This is a critical factor and the assessment must avoid the risk of hindsight bias and recognise that the funder took on those risks at the commencement of the proceeding;

(e) the quantum of adverse cost exposure that the funder assumed. This is another important factor and the assessment must recognise that the funder assumed that risk at the commencement of the proceeding..."

22. In class actions, should lawyers and litigation funders be able to request that the total amounts they receive in settlement be kept confidential?
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7.34. In IMF's submission, transparency in respect of settlement amounts and amounts received by lawyers and litigation funders is welcome. Often, confidentiality requests are driven by defendants, and not plaintiffs or litigation funders.

7.35. IMF, as an ASX listed company, has no issue with disclosure of amounts it receives in settlements. IMF already reports to the market its returns arising from the resolution of the class actions that it funds, as part of its continuous disclosure obligations.

23. How could the management of settlement distribution schemes be improved to:

⁷⁶ [2015] FCA 811.

⁷⁷ *Ibid* at [7].

⁷⁸ At [80(d) and (e)].

- (a) ensure that individual compensation reflects the merits of individual claims; and
- (b) ensure that it is completed in a manner that minimises costs and delays?

7.36. IMF is very interested in any measures that ensure, not only that individual compensation reflects the merits of individual claims, but that the settlement distribution is completed in a manner that minimises costs and delays. Once it has funded a matter to resolution, IMF does not want the claimants to feel that the distribution is unfair or subject to unnecessary costs and delay.

7.37. In class action settlements, the distribution of the settlement takes place in accordance with a Court-approved settlement distribution scheme. In respect of compensation reflecting the merits of individual claims, IMF endorses the approach taken by Australian courts where the design of a settlement distribution scheme aims to achieve vertical equity (more deserving claimants should receive more than less deserving claimants) and horizontal equity (similarly situated claimants should receive similar awards).⁷⁹

7.38. However, IMF also agrees that “[t]here is a trade-off between precision and cost that must be managed so as to ensure settlement funds are distributed fairly”⁸⁰. Rough justice may be appropriate when compared with the costs and delay associated with alternatives.

7.39. Once the Court has approved a settlement distribution scheme, the Court is required to appoint an administrator to manage and oversee the scheme. Often the lawyers that conducted the class action are appointed as administrator. In certain matters, the appointment of those lawyers may be appropriate and efficient, given the factual and legal knowledge the lawyers have about the case that may assist in the oversight of the scheme. IMF submits, however, that the courts should give greater consideration to appointing an administrator, other than the lawyers that conducted the action, where:

- the settlement distribution would likely be conducted at less cost and more quickly;
- it is unnecessary to have lawyers, at lawyer rates, undertake an administrative function;
- the lawyers are likely to be less efficient than an administrator with more relevant expertise;

⁷⁹ See Consultation Paper, paragraph 7.129.

⁸⁰ Michael Legg, *Class Action Settlements in Australia – the Need for Greater Scrutiny*, (2014) 38(2) Melbourne University Law Review 590.

- all that is required is the application of the Court approved scheme and there is little merit in having lawyers with the factual and legal knowledge acquired in conducting the class action implement the scheme;
- the lawyers are likely to largely outsource the calculation or determination of merits in any event; and/or
- the lawyers do not have any particular expertise in the application of formulas or claim assessment used by the settlement distribution scheme.

24. How could Court-approved notice for opt out and settlement be made clearer and more comprehensible for class members?

7.40. The Supreme Court and Federal Court Practice Notes set out requirements with respect to opt out and settlement notices. As set out in response to the questions in Chapter 4 above, in IMF's submission, any attempt to further prescribe the content of those notices is unlikely to be helpful. All class actions and settlements are different and the current requirements in the Practice Notes enable settlement notices to be tailored to the circumstances. While clarity and comprehensibility are obviously important, the content of the notices will be highly depend on the particular disclosure required in the circumstances of the case.

7.41. Under the current regime, while the Court has a role in approving opt out and settlement notices, the lawyers also have a duty to make every effort to ensure the notices disclose all necessary information and are clear. Where notices fail to provide adequate disclosure or lack sufficient clarity, as occurred in Willmott Forests, the Court can decline to approve a settlement that depends upon the adequacy of those notices.

25. Are there other ways the process for settlement approval and distribution could be improved?

7.42. Please see IMF's submission in response to question 23 above.

8. Contingency fees

26. Would lifting the ban on contingency fees mitigate the issues presented by the practice of litigation funding?

8.1. IMF considers that the current model of third party litigation funding, in which the funder operates at arm's length to the lawyers, is more beneficial for clients and subject to less risks than contingency fee charging by lawyers. Although IMF accepts that allowing Australian lawyers to charge contingency fees would be likely to increase competition for litigation funders,

any introduction of contingency fees must require contingency fee lawyers to be subject to adverse costs exposure. This is necessary, not just for the protection of claimants, but also to prevent the cost-shifting/loser pays rule being circumvented.

Conflicts of interest

- 8.2. In IMF's submission, lifting the ban on contingency fees would not mitigate but, on the contrary, increase the conflicts issues that can arise due to the practice of litigation funding. Under the current system, the tripartite relationship in funded proceedings, between the litigation funder, the lawyers and the funded plaintiff, provides important checks and balances, as set out in more detail below.
- 8.3. If the lawyer was also the litigation funder, there would be no independent lawyer to provide objective advice to the client when the client's interests conflicted with the contingency fee lawyers' interests. Under IMF's litigation funding agreements, where the lawyer believes there is a conflict with respect to the obligations they owe to the claimant and to IMF, the lawyer is to advise and take instructions from the claimant, whose interests are paramount, even if that is contrary to IMF's interests.
- 8.4. Professor Morabito explained the conflicts that could arise for contingency fee lawyers in the following terms⁸¹:

"The most persuasive criticism of contingency fee agreements is the potential for conflict of interest which they create in relation to such matters as settlement of the client's claim. The contingent nature of the lawyer's remuneration creates a strong financial incentive for the lawyer to 'accept a small settlement in order to ensure some fees, rather than risk losing at trial and recovering nothing'. This incentive to settle for sub-optimal amounts would appear to exist in relation to both uplift fees and percentage fees.

An obvious response to this argument is to say that a client would not accept settlement terms which are contrary to his/her own best interests. Unfortunately, the fear of losing, 'the client information disadvantage and the inability to evaluate' the validity of the settlement package recommended by the lawyer may result in the client's authorisation of inferior recoveries.

The losses incurred as a result of the conflicts of interest which exist between principals and agents are described by economic scholars as 'agency costs'. Given the unreliability of 'monitoring' by the client as a means of reducing agency costs, reliance must be placed on other safeguards such as the legal regulatory system and the importance placed by lawyers on maintaining a good reputation. It is difficult to see, however, how

⁸¹ V. Morabito, *Federal Class Actions, Contingency Fees, and the Rules Governing Litigation Costs* (1995) 21 Monash U L Rev 231, 246 – 247.

the prospect of disciplinary action or loss of reputation can provide an effective means of eliminating agency costs in the context of settlements given that the lawyers in question are able to point to the 'objective' fact that they have achieved a victory on behalf of their clients."

8.5. As IMF submitted to the Productivity Commission on this issue:

"Third party litigation funding can reduce the agency problem by ensuring that the lawyer is remunerated regardless of the outcome to the litigation and by introducing a sophisticated and skilled repeat litigant whose interests are aligned with the claimant's but who does not suffer the same level of information disadvantage as the claimant."⁸²

And:

"The policy considerations for requiring the traditional fiduciary duties of lawyers to their clients to be unfettered by any third party funding are compelling."⁸³

8.6. Chapter 3 of the Consultation Paper discussed potential conflicts of interest that exist in funded class actions under the current system. Paragraph 3.61 stated that:

"Conflicts of interest are particularly likely to arise within this relationship where:

- In a class action, the lawyers act for all class members, who have differing claims and needs which may conflict;*
- There is a pre-existing legal or commercial relationship between the litigation funder and lawyers; and*
- The funder has the control of, or the ability to control, the conduct of proceedings".*

We have addressed each of these potential conflicts in funded class actions below.

Lawyers acting for all class members

8.7. In IMF's view, the class action regime that has developed in Australia until recently, where litigation funders funded closed class actions, removed conflicts between class members based on whether they had signed funding agreements or not. Insofar as class members that had not entered into funding agreements became entitled to participate in a settlement in a proceeding funded by a litigation funder, litigation funders sought to reduce these conflicts by applying for funding equalisation orders.

⁸² IMF's initial submission to the Productivity Commission at [4.70].

⁸³ Ibid at [4.72].

- 8.8. Common fund orders are expected to introduce a new mechanism to reduce or remove a conflict that might otherwise arise because some class members are funded and others have not entered into funding agreements.
- 8.9. In IMF's view, Willmott Forests shows that conflicts between class members can exist and in fact intensify in situations where there is no third-party litigation funder involved in the litigation.
- 8.10. If contingency fees for lawyers are permitted, potential conflicts between class members that have signed a retainer with the contingency fee law firm and class members that have not will continue to exist under a lawyer contingency fee model. The case of Willmott Forests revealed how lawyers might favour the clients from whom they have been paid a fee, be it at an hourly rate or on contingency, over class members that do not.

Pre-existing legal or commercial relationship between the litigation funder and lawyers

- 8.11. Under a lawyer contingency fee model, the law firm would be both litigation funder and lawyer. IMF respectfully disagrees with the statement in paragraph 8.38 of the Consultation Paper which stated that lifting the ban on contingency fees could *"reduce the risk of a conflict of interest between the litigation funder and the client, and assuage concerns about the relationship between the litigation funder and the lawyer"*. In these circumstances, the litigation funder would be the lawyer and the lawyer's risks of conflict with his or her client would be far greater and directly compromise his or her ethical and professional obligations to serve the best interest of the client⁸⁴.
- 8.12. In IMF's submission, in a market the size of Australia, it is inevitable that a funder may have previously funded litigation with a firm of lawyers who seek funding for a new case. However, there is no evidence that in the Australian market, litigation funders and lawyers do not operate on an arms-length basis.
- 8.13. Contingency fees will not mitigate this conflict, but will intensify the level of this conflict for lawyers. A lawyer acting on a contingency fee basis will not have the benefit of the tripartite relationship, in which the lawyer acts as a check and balance on any conflict of interest between the claimant and the litigation funder, with respect to control over the proceedings, and the litigation funder (as an experienced litigator) acts as a check and balance on any conflict of interests between the claimant and the lawyer with respect to legal costs and efficiency.

⁸⁴ See Consultation Paper, paragraph 8.39.

Litigation funder's ability to control proceedings

- 8.14. Under a lawyer contingency fee model, the lawyer as litigation funder would have near complete control over the litigation due to the information asymmetry⁸⁵. As noted at paragraph 8.42 of the Consultation Paper, the plaintiff's only source of information and advice about the conduct of the litigation would be from a party with a direct financial interest in the outcome. The checks and balance of the tripartite arrangement when a third party litigation funder is involved would be lost.
- 8.15. In IMF's submission, Justice Murphy's decision on the settlement approval application in Willmott Forests, a class action where there was no third-party litigation funder involved, provided a clear example of why it cannot be assumed that a contingency fee lawyer would be in a better position to manage these conflicts, compared to lawyers and litigation funders under the tripartite relationship.

Contingency fees and costs

- 8.16. In IMF's submission, there is no evidence to show that funding costs would be reduced under a contingency fee model. As noted in the Consultation Paper⁸⁶, there are very few law firms that would have the capital and risk appetite to fund class actions, including disbursements and provide adverse costs cover. It is likely that law firms will still look to third party litigation funders to help finance some of the proceedings and/or adverse costs cover. There is also a risk that any changes which put too much downward pressure on funding fees could end up causing less competition in the litigation funding market if funders' return on investment became too low to absorb the risks they are required to undertake, particularly adverse costs risks.

Case selection and unmet demand

- 8.17. As noted in the Consultation Paper and above, third-party litigation funders undertake rigorous due diligence on the cases they fund. This rigorous case selection ensures that cases that are funded are assessed as having strong prospects of success. Paragraph 8.5 of the Consultation Paper implied that the rigorous case selection of litigation funders may be relaxed if lawyers were permitted to charge contingency fees. In IMF's view, any lowering in the standard of the selection process would result in more claims, resulting in a greater burden on the Courts, greater cost and inconvenience to defendants, financial risks to law firms and, as a result, potentially greater financial risk to claimants. It is in the interests of the Courts, claimants, defendants and the financial survival of the law firms, that contingency fee lawyers apply the same rigorous processes as litigation funders currently do.

⁸⁵ See the quote from Professor Morabito at paragraph 8.4 above.

⁸⁶ Paragraph 8.27.

8.18. In IMF's submission, there is no evidence to show that lawyers charging contingency fees would fund a greater range of cases, including social justice cases.

8.19. Paragraph 8.10 of the Consultation Paper stated there was a suggestion that there is an unmet demand among small-to-medium enterprises for business-to-business litigation services, which could be met if lawyers were able to charge contingency fees. IMF's experience is that litigation funders, particularly some new entrants to the market, are increasingly looking to service the smaller claim side of the market. One example is a funding solution for claims over \$500,000 combining a no-win no-fee or conditional fee agreement with litigation funding called 'Cost certain access to business litigation' (CCABL). This is offered by a law firm that services small-to-medium businesses. The brochure provides under 'How it works':

"[lawyer] will work with you to understand the real cost and potential net outcome of your case. He will then liaise with a panel of the best litigation funders in Australia to select a Funder suited to your case.

A partnership between your business, [law firm] and the Funder is then agreed. You and the funder will pay a capped monthly fee contribution up to an agreed fee maximum for the case.

[law firm] will accrue the balance of any fees and disbursements on a monthly basis. The accrued fees and the Funder's commission are only paid on a successful outcome of your case."

8.20. In IMF's view, there are sufficient litigation funders in the market and lawyers able to offer conditional fee agreements, that it would be surprising if small-to-medium businesses with meritorious claims are not able to access either third party litigation funding or a conditional fee agreement or a combination of both.

27. If the ban on contingency fees were lifted, what measures should be put in place to ensure:

- (a) a wide variety of cases are funded by contingency fee arrangements, not merely those that present the highest potential return;
- (b) clients face lower risks and cost burdens than they do now in proceedings funded by litigation funders;
- (c) clients' interests are not subordinated to commercial interests; and
- (d) other issues raised by the involvement of litigation funders in proceedings are mitigated?

8.21. IMF submits that, if the ban on contingency fees were lifted, lawyers who wished to act on this basis should be subject to the same potential liability to pay adverse costs if the litigation in which they act is lost, as litigation funders face in litigation contingently funded by them. The power to make such an order should be set out clearly in the Court rules or legislation. Lawyers should also be subject to the proposed regulatory reforms set out in section 9, including the recommendation by the Productivity Commission.

28. Are there any other ways to improve access to justice through funding arrangements?

8.22. In IMF's submission, the current system would be improved by further regulation of litigation funding at the Commonwealth level (see section 9 below).

8.23. In addition, the introduction of common fund orders are likely have the effect of not only broadening access to justice in class actions, through the associated open class actions, but also to subject litigation funding fees to greater assessment and supervision by the Court.

8.24. Reforms to address the increasing costs of litigation, including the costs budgeting suggestions made above, would contribute towards improving access to justice. Another possible measure might be to enable Courts to make "barring" orders which would enable a Court to bar a cross claim, in circumstances where one respondent wished to settle with the claimant at a reasonable amount, but other respondents did not wish to settle. The barring order would bar the cross claims from other respondents, in order to permit a reasonable settlement with one respondent to proceed.

9. Conclusion - Regulatory reform

9.1. As set out in the Consultation Paper and above, litigation funders are now required to maintain written procedures to effectively manage conflicts of interest that may arise in funded litigation.

9.2. IMF initially applied for and obtained an Australian Financial Services Licence (believing at that time that litigation funding could be a financial product). Once it became clear that it was not, IMF gave up its licence, in preference to complying with the conflicts regulations.

9.3. The regulatory model which has emerged since 2010 places a light compliance burden on litigation funders and poses minimal regulatory barriers to entry. This "light touch" approach has facilitated the availability of litigation funding from a range of funders and therefore increased competition in the industry. However, in IMF's submission, a difficulty with the current model is

that there is no capital adequacy standard to guard against the risk of an under-capitalised funder failing to meet its financial obligations.⁸⁷

9.4. As IMF submitted to the Productivity Commission:

“Litigation funders provide financial support to cases claiming billions of dollars. They make financial promises which extend over many years and which, if broken, will cause much heartache and financial distress to their clients. It is important to the clients, defendants and the courts that funders have both longevity and ongoing financial capacity. Funders play, for the plaintiff, a similar role to that played by insurers for the defendant. Insurers are required to be licensed and the same must surely apply to litigation funders.”⁸⁸

9.5. IMF therefore supports the conclusion reached by the Productivity Commission in its 2014 report⁸⁹:

“The Australian Government should establish a licence for third party funding companies designed to ensure they hold adequate capital relative to their financial obligations and properly inform clients of relevant obligations and systems for managing risks and conflicts of interest.

- *Regulation of the ethical conduct of litigation funders should remain a function of the courts.*
- *The licence should require litigation funders to be members of the Financial Ombudsman Scheme.*
- *Where there are any remaining concerns relating to categories of funded actions, such as securities class actions, these should be addressed directly, through amendments to underlying laws, rather than through any further restrictions on litigation funding.”*

⁸⁷ W Attrill, *The Regulation of Conflicts of Interest in Australian Litigation Funding*, (2013) 2 *Journal of Civil Litigation and Practice* 193.

⁸⁸ IMF's initial submission to the Productivity Commission at [4.41].

⁸⁹ The Productivity Commission recommended (Recommendation 18.2).