TAKING THE FLOOR: GOVERNMENT PROPOSES TO LEGISLATE A RECOVERY PRESUMPTION FOR FUNDED CLASS ACTION GROUP MEMBERS

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Legal Briefings – By **Jason Betts, Christine Tran and Brock Gunthorpe**

On 30 September 2021, the Department of Treasury opened consultation on new laws which, if enacted in their proposed form, will introduce new hurdles for litigation funders intended to ensure fairer returns for group members in future funded class actions.

The reforms continue the Government's recent legislative activity in the class action space, having made substantive amendments to continuous disclosure laws in August 2021 directed at shareholder class actions.

The exposure draft titled *Treasury Laws Amendment (Measures for Consultation) Bill 2021* (**Exposure Draft**) gives effect to a range of recommendations made by last year's Parliamentary Joint Committee inquiry into the class action industry. As outlined on Thursday by the Treasurer and Attorney-General, the new reforms are designed to:[1]

enhance court oversight of the distribution of class actions proceeds between the litigation funder and plaintiffs who are members of a class action litigation funding scheme...[and] further protect plaintiffs...[through] a rebuttable presumption that a return to the general members of a class action litigation funding scheme of less than 70 per cent of their gross proceeds is not fair and reasonable.

BACKGROUND

Corporations Amendment (Litigation Funding) Regulations

In August 2020, the Australian Federal Government increased regulatory oversight of class action litigation funding schemes by removing the 'managed investment scheme' (MIS) and other financial services regulatory exemptions from litigation funders.

Under the new regulations, class action litigation funding schemes became subject to *Corporations Act 2001* (Cth) requirements applying to financial products, such as the requirement to hold an AFSL, comply with license conditions, and adhere to increased duties and obligations relating to dealings with scheme members.

A cap is born

Later in 2020, during a Senate debate on an Opposition motion to disallow those changes (which the current Government defeated), some members of the crossbench expressed concern about their perception of comparatively low levels of returns to group members in funded class actions (compared to the recovery of those that promote them). In media comments in December 2020, Senator Hanson outlined an apparent commitment to negotiate additional safeguards for group members, including a 70% minimum recovery.

The matter was subsequently addressed in the deliberations on the Parliamentary Joint Committee on Corporations and Financial Services' report into *Litigation funding and the regulation of the class action industry* delivered in late December 2020 (**PJC Report**).

Government Consultation

More recently in May 2021, Attorney-General Cash announced that the Government would consult on recommendations of the PJC Report which could be implemented by the Government, and 'in particular Recommendation 20 which proposes the introduction of a guaranteed minimum rate of return for class action members'.

Mixed market reaction

Throughout the balance of 2021, the mooted statutory minimum recovery has been met with caution by a range of users of the class action procedure and a range of industry participants. Opponents of the proposal, including a prominent litigation funder, commissioned research which suggested that the number of 'viable' class actions for litigation funders could reduce by as much a third if the proposal were legislated. Nonetheless, there remains support in the industry generally for a statutory cap on funders' recoveries, as seen in responses to the Attorney-General's consultation.

EXPOSURE DRAFT

Interested parties have been given a tight deadline by Treasury for submissions on the Exposure Draft – 7 days in total. The narrow window for considering a complicated legislative initiative is challenging, given the magnitude of the changes being consulted on (discussed further below). This article canvasses the changes, as well as offering some possible implications that might arise for further consideration if the Exposure Draft is introduced as a bill in Parliament.

The Government intends to only make the changes prospective, meaning that any class actions already commenced will be exempt from the new rules when introduced. Instead, only those litigation funding schemes entered into after the commencement of any legislation will be caught.[2] The key amendments are set out below.

Legislative Scheme

If passed, the Exposure Draft would impose a procedure (at the time for distribution of monies arising from the litigation) which:

1. renders any funding agreement between litigation funder and group member unenforceable (in respect of the distribution of monies) in the absence of court approval;[3]

2. requires the Court to:

    a. obtain a referee's opinion (at the funder's expense); and

    b. have regard to a contradictor's submissions (also at the funder's expense),

in relation to the funder's share of any monies;[4] and

3. requires the Court to be satisfied that the proposed distribution is "fair and reasonable considering the interests of the scheme's general members as a whole";[5] but,

4. further requires the Court to presume that a distribution which provides for less than

70% of the gross claim proceeds to be paid to group members ‘is not fair and reasonable’.[6]

The Court will retain a discretion to do away with a referee or contradictor, if not in the interests of justice.

Fair and Reasonable Test

In determining whether a distribution to a litigation funder is fair and reasonable, the Exposure Draft would see the Court’s determination limited to the following prescribed factors:[7]

1. the amount, or expected amount, of claim proceeds for the scheme from the proceeding;
2. the legal costs for the proceeding incurred by the funder and the extent to which those legal costs are reasonable;
3. whether the proceedings have been managed in the best interests of the general members to minimise the legal costs for the proceedings;
4. the complexity and duration of the proceedings;
5. the extent of the commercial return to the funder for the scheme, in comparison to the costs incurred by the funder in relation to the scheme;
6. the risks accepted by the parties to the agreement by becoming parties to the agreement;
7. the sophistication and level of bargaining power of the general members in negotiating the agreement; and
8. any other compensation or remedies obtained by any of the scheme’s general members in relation to the subject matter of the proceeding.

The list would be able to be supplemented or revised by Regulation at any time, but the 70% presumption would be legislatively enshrined, and unable to be later amended, or disallowed by the Senate.

Other Amendments

Although the primary focus of the Exposure Draft is legislating a scheme to ensure fair and reasonable returns to plaintiffs, the draft amendments throw up a range of other issues. These include:

1. **Limiting CFOs:** Consistent with the Government's policy that group members should consent in writing to a funder's commission, the Exposure Draft disincentivises funders from seeking CFOs. The Bill does so by, in essence, rendering all funding agreements unenforceable if the Court makes a CFO in the proceedings.[8] Presumably, this is intended to discourage litigation funders from seeking such orders in the first place.

2. **Nationalised funding requirements:** Notwithstanding that class action procedures are governed by State law outside the federal jurisdiction, the Exposure Draft reforms are expressed to apply to all class action litigation funding schemes regardless of jurisdiction.[9] The Bill does so by rendering the distribution of monies contingent on litigation funders receiving court approval under State powers that are 'substantially similar' to those in draft section 601LG.

3. **Written consent requirements**: The Exposure Draft amendments impose a 'written consent' requirement before a group member can be bound by the funding agreement.[10]

4. **Irrevocable commitment to Australian jurisdiction:** The Exposure Draft amendments require funders to irrevocably submit to the jurisdiction of Australian Courts.[11]

IMPLICATIONS

Given that the Exposure Draft is only an early expression of the Government's policy intentions, there remains scope for revision prior to the bill being legislated.

In its present form, some of the implications for consideration prior to the bill being introduced to Parliament include:

- **Possible unintended consequences for claim finality**: The Exposure Draft changes may incentivise class action promoters to revert to the use of 'closed classes', presenting finality complications for defendants. These 'closed classes', where only a subset of group members participate, can be hard for defendants to resolve before trial, because of the risk that the settlement will trigger a copycat proceeding on behalf of the group members excluded from the settled claim. To borrow the language of one prominent judge, class action reforms can sometimes lead to a 'whack-a-mole' game, where (in this

case) resolving the issue of excessive funding returns may create a new problem for defendants in achieving finality when settling funded class actions.

- **Multiplicity issues**: An increase in 'closed classes' may create more instances of multiple class actions being commenced in relation to the same subject matter. While recent experience indicates how the Courts might approach addressing competing open classes, and to a lesser extent competing open/closed classes, competing closed classes are, generally speaking, harder to regularise and raise complicated questions of whether one or multiple closed classes should be permitted to proceed, especially where there is no overlap in group membership between closed classes.

- **Unintended upwards increase in settlement expectations**: Consideration will need to be given to whether the '70% return to group members presumption' in the Exposure Draft could have the effect of increasing settlement expectations or targets of those that promote class actions, requiring defendants to pay more if they wish to resolve class actions before trial. Take a hypothetical: Assume settlement could in the past be achieved for a payment of $50 million, comprising $10 million (20%) in plaintiff legal costs, and $10 million (20%) of funders' commission, leaving $30 million (60%) to be distributed to group members. By the time of mediation, the majority of legal costs are sunk and the funder may have firm expectations (supported by funding agreements) as to the percentage commission they need to extract to resolve the proceeding before trial. Accordingly, will the presumption mean that the this proceeding could not settle for less than $67m – a total amount that would allow both the 70% presumption to be met, and a $10 million return to the funder)? Alternatively, will more cases have to go to trial? Additionally, it may take some time for the jurisprudence to develop, giving rise to increased settlement uncertainty in the short term as to the application of the presumption.

- **Effective 'split' between funded class actions, and class actions supported by lawyers charging contingency fees**: The Exposure Draft appears to exclude 'no win, no fee' and contingency fee arrangements (i.e. where no third party funder is supporting the proceeding). Is this creating different standards for different types of class actions and is that an acceptable policy choice? Presumably, the Exposure Draft reflects a policy decision that claims supported by no-win, no-fee arrangements or contingency fees are less in need of reform, because group member returns are likely to be higher than in third party funded litigation (given the absence of litigation funder's commission).

- **The effective introduction of an opt-in system for funded class actions**: While the 'opt in' requirements of the Exposure Draft are confined to funding agreements between a funder and group members, and can, therefore, be reconciled with the overall 'opt out' regime in Part IVA of the Federal Court of Australia Act 1976 (Cth), uncertainty will arise in the interface between the proposed reforms and the current machinery of Part IVA, which may result in increased interlocutory disputation. Recent appellate decisions on the Court's powers have emphasised the 'opt out' nature of the Part IVA; but how will the Court's current Part IVA powers be used in a funded proceeding with an 'opt in' mandate? For instance, how might the Court exercise powers under sections 33K or 33ZF part-way through a funded closed class proceeding to amend the class definition to include unfunded group members, assuming that is even permissible?

Given the foregoing, it will be interesting to see how many of these questions are ventilated and addressed in the short consultation window.

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1. Hon Josh Frydenberg MP, 'Ensuring Fair and Reasonable returns to class action plaintiffs' (30 September 2021)
2. Exposure Draft, section 1688.
3. Exposure Draft, s 601LF(1).
4. Exposure Draft, s 601LG(6).
5. Exposure Draft, s 601LG(1).
6. Exposure Draft, s 601LG(5).
7. Exposure Draft, s 601LG(3)(a)-(f).
8. Exposure Draft, s 601LF(2)(c), (3)(d), (4)(d).
9. Exposure Draft, s 601LF(4).
10. Exposure Draft, s 601GA(5)(a).
11. Exposure Draft, s 601GA(5)(c).

KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.

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