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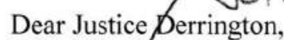
12 July 2018

The Hon Justice S C Derrington
President
Australian Law Reform Commission
GPO Box 3708
SYDNEY NSW 2001

By email: class-actions@alrc.gov.au



Dear Justice Derrington,

Inquiry into Class Action Proceedings and Third-party Litigation Funders.

As the Presiding Commissioner for the Productivity Commission's (the Commission) Inquiry into Access to Justice Arrangements in 2013-14, I have had the benefit of previously studying the issue of access to justice and of contributing to identifying how equity and access can be improved.

The Report of the Productivity Commission's Inquiry into Access to Justice Arrangements (the Report)[1] was described by the Law Council of Australia as "*the most comprehensive review of access to justice arrangements in Australia ever attempted*".

The Commission thoroughly examined:

- the real costs of legal representation and trends over time;
- factors that contribute to the cost of legal representation;
- the proportionality of the costs of accessing justice services; and
- the alternative mechanisms to improve equity and access.

It is a testament to our system that procedural and other issues that may improve access to justice repeatedly undergo review so that we may avoid counterproductive and inequitable barriers preventing Australians from exercising their rights, and allow them to do so in the most time and cost efficient manner.

The ALRC's Discussion Paper covers a range of topics of particular importance and concern, including a number the Commission addressed in its Report. The Report explores access to justice at great length, recommending various reforms to enhance it as well as identifying potential barriers which could inhibit it.

The Commission expressed a view that "*a just outcome is likely to be associated with fair and transparent processes – confidence in the integrity of the process instils confidence in the outcome reached*". The Report concludes that the transparency and integrity of our system is placed at risk by costs and delays associated with the system, the complexity of the system and the law which underpins it, and an absence of mechanisms to enforce rights in certain circumstances.

I have focused my submission to the ALRC around the proposals and questions outlined in chapters 1, 3 and 5 of the Discussion Paper.

[1] http://www.pc.gov.au/inquiries/completed/access-justice/report. Report Overview

Chapter 1 – Introduction to the Inquiry

ALRC Proposal 1–1
I strongly support Proposal 1-1.

During the course of the Commission's Inquiry it was clear that the weight of the argument to restrict litigation funding and innovation in solicitor charging came from those representing interests (both in a legal and a public policy sense) that were the subject to actions under the *Corporations Act 2001*(Cth), particularly in relation to continuous disclosure and directors duties. In response to these concerns the Commission noted: "*public debate about the underlying law is clearly more appropriate than attempting to stifle a mechanism that provides broader access to justice mechanisms*" (p.621) This proposal does exactly that.

Chapter 3 - Regulating Litigation Funders

ALRC Proposal 3–1
The Report made the following observation[2]:

> *Overall, while the Commission judges that third party litigation funding can provide important benefits for access to justice, consumers need to be adequately protected and have some assurance that funders will follow through on financial promises. Therefore, in addition to oversight by courts, funders need to be licensed to ensure they hold adequate capital to manage their financial obligations. Licensing of litigation funders was broadly supported.*

Accordingly, the Commission made the following recommendation:

Recommendation 18.2:
The Australian Government should establish a licence for third party litigation 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.* (p.61)

The Report and Proposal 3-1 share the view that a licensing system for third party funders is desirable. There is broad agreement that the basis of that licence should be to ensure that the third party litigation funder has the wherewithal in relation to capital and systems to properly fulfil their role.

There is difference, however, in how that licencing system should be administered. In the course of the Commission's Inquiry there were a range of views put to us regarding the appropriate agency to attend to licensing and dispute handling. There was no easy answer to this and given the imminent establishment of the Australian Financial Complaints Authority, if the Commission were to have been considering these issues today, it may have formed a different view. Suffice to say though the Commission saw two particular tasks – one being of a consumer protection character (disclosure, prudential adequacy etc) and the other relating to ethical conduct involving court proceedings – in relation to the latter the Commission was firmly of the mind these were matters for the Courts.

ALRC Proposal 3–2
The provisions listed in Proposal 3-2 are in line with the outcomes of the Productivity Commission's recommendations.

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[2] Ibdi, p.22-23

In comparing litigation funding to contingency funding, the Commission was of the view that there is very little difference in the financial incentives faced by lawyers billing on a contingency basis and litigation funders. As such, lifting the ban on contingency fees (see my response to Chapter 5 below) would generate additional competition for the currently small number of litigation funders and ultimately force down their percentage of fees, to the ultimate benefit of legal clients.

The evidence that was available to the Commission also made clear that access to financing by third party funders was not available to small and isolated litigants due to the economies of scale inherent in the business of litigation funders. As a result, many small, meritorious claims, deemed financially unviable by litigation funders may not be tested in the legal system as lawyers are unable to proceed with complex litigation on a conditional fees basis under the current regime without third party support. It seems that a significant number of such claim may proceed if contingency fees were allowed.

Chapter 5 – Commission Rates and Legal fees

The failure to lift the ban on contingency fees will inhibit the efficiency, effectiveness and the likelihood of access to justice for thousands of Australians with meritorious claims.

In the Report[3], the Commission cited Chief Justice of Western Australia, The Hon Wayne Martin AC:

> *The hard reality is that the cost of legal representation is beyond the reach of many, probably most, ordinary Australians. ... In theory, access to that legal system is available to all. In practice, access is limited to substantial business enterprises, the very wealthy, and those who are provided with some form of assistance.*

The Commission noted that those on high incomes are thought as being able to bear the costs, and those on low incomes are provided with publicly funded schemes such as legal aid. But access to justice is often limited for those in what we deemed 'the missing middle'. Similar challenges are likely to be faced by many small and medium sized businesses, especially in disputes with larger busineses that are their customers or suppliers.

Class actions provide a cost effective mechanism through which access to justice for many may be achieved. The Commission found that the lifting of the prohibition on contingency fees would take us a long way toward achieving that goal.

ALRC Proposal 5–1
This proposal is broadly in line with the Commission's findings in relation to contingency fees and to this end I endorse it.

If Proposal 5-1 is endorsed, uncertainty surrounding the potential total of costs at the end of a matter is eliminated, as contingency fees are results based and clients assured at the outset that their costs will be proportional to the recovery. This compares with cases operating on a conditional fees basis where clients may be left without sufficient funds from their recovery to cover the lawyer's full fee.

There should be only one funder, and only one billing regime involved in a case.

The Productivity Commission's terms of reference directed it to consider a wide range of mechanisms by which the financial costs of litigation, that are recognised to present barriers to access to justice, can be reduced. The Commission's broad conclusions, and my firm belief is that there should be no prohibitions on the fee structures that lawyers may use to charge their clients, provided that those structures are fully explained and understood by clients. In relation to contingency fees, the Commission made the following recommendation:

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[3] Ibid, p.6.

Recommendation 18.1:
The Australian, State and Territory Governments should remove restrictions on damages-based billing (contingency fees). This recommendation should only be adopted subject to the following protections being in place for consumers:

- *the prohibition on damages-based billing for criminal and family matters, in line with restrictions for conditional billing, should remain.*
- *comprehensive disclosure requirements — including the percentage of damages, and where liability will fall for disbursements and adverse costs orders — being made explicit in the billing contract at the outset of the agreement.*
- *percentages should be capped on a sliding scale for retail clients with no percentage restrictions for sophisticated clients.*
- *damages-based fees should be used on their own with no additional fees (for example, lawyers should not be able to charge a percentage of damages in addition to their hourly rate).*[4]

As noted above, these protections are broadly in line with Proposal 5-1 of the Discussion Paper.

The fact that both the Commission's Report and Proposal 5-1 note the need for limitations on contingency fee arrangements highlights that there are potential fears and dangers associated with removing the ban on their use. Many of these fears are based around the ethical conduct of the legal profession.

There has been much speculation as to whether the availability of contingency fees would promote unmeritorious and frivolous litigation, and create a conflict of interest between the lawyers' duty to their client and their financial interest in the outcome of the case. I address these two issues below.

Meritorious claims:
I disagree that the availability of contingency fees would discourage lawyers from fully considering whether a case is meritorious before proceeding. Regardless of billing arrangements, cases that run on a 'no win no fee' basis leave lawyers at risk of not recovering their fees in the event that the case is lost, therefore already providing financial incentive to proceed only with claims that have a reasonable chance of success.

This argument also seems to ignore the real and active role that judicial officers play in this regard, the likelihood that 'docket' based case management is likely in itself to reduce the number of cases lacking merit that are bought to trial, and the general duties lawyers owe to Courts.

Further, the Commission concluded that adverse costs orders are an inherent disincentive to pursuing high risk claims with a low likelihood of success, as claimants would face the threat of paying the other side's legal fees and the lawyers would face the prospect of bearing the cost of litigation. This is particularly the case in the presence and possibly increased use of indemnity cost orders and if higher levels of recovery of court costs were to be implemented as the Commission recommended. Contrary arguments are likely based on United States evidence, a jurisdiction that does not have the same adverse costs laws as Australia.

It has been demonstrated through the introduction of contingency fees in Ontario and the United Kingdom that adverse costs orders act as a sufficient deterrent to pursuing frivolous claims, and maintain the integrity of litigation. This is consistent with the view the Commission formed of the empirical evidence available at the time. If contingency fees were to be introduced into Australia in the same way, restrictions could be imposed on the nature of claims for which contingency fee arrangements may be applied, such as those recommended by the Commission that I have mentioned above.

Conflicts of Interest:
The Commission was of the view that people seeking access to justice should not be denied the use of a funding mechanism on the basis of concerns about the professional or ethical conduct of lawyers. Indeed, I did find it strange at varying times during the Inquiry that professional bodies would argue that there was

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[4] Ibid, p.61.

no need to improve ethical and professional supervision of solicitors and then on the other hand deny litigants access to certain funding mechanisms because of concerns about lawyer conduct.

Potential conflicts of interest between lawyers and their clients are not unique to a contingency fee regime. Lawyers clearly have a financial interest in the outcome of their cases and clients are at risk of being charged excessive fees irrespective of the billing structure.

Contrary to the speculation that contingency fees could generate conflicts of interest between lawyers and their clients, it can be argued that contingency fee arrangements would have the opposite effect and in fact align their interests in respect of achieving the highest value recovery.

It could be said that lawyers who are paid by the hour may be motivated by pursuing lengthy litigation and unnecessary pre-trial activity, benefitting from maximising the number of hours worked irrespective of the outcome of the litigation. On the other hand, under a contingency fee arrangement, time billed becomes largely irrelevant and the lawyers and clients mutually focus on resolving the dispute without inefficiencies and delays.

This may also have the knock on effect of reducing the demand on the resources of the court system.

In response to ALRC Question 5-1 relating to whether prohibition on contingency fees should remain with respect to some types of class actions, I believe that the prohibition on damages-based billing for criminal and family matters, in line with restrictions for conditional billing, should remain.

On reflection however, at the Commission we did think that for relatively small claims the incentives and risks associated with conditional and contingency fees arrangements were likely to be quite similar. As such I am not convinced that a prohibition on personal injury matters is appropriate but can see why for abundant caution, at least for initial period, this might be appropriate.

ALRC Proposal 5–2:
I agree with this proposal in principle.

Should this proposal be adopted, there would need to be clear guidelines developed and implemented by which the court can grant its permission. These guidelines should provide standardisation and predictability to the process for seeking permission.

There is a risk that this process could create unnecessary regulatory burdens for both the Courts and litigants. It is important that it not delay proceedings unnecessarily. A checklist which could be administered by the Registrar or similar should suffice.

ALRC Proposal 5–3
I do not agree with this proposal.

I draw ALRC's attention to the fact that several jurisdictions, including California, New York and Scotland have adopted sliding-scale billing models that are not judicially determined. Despite the existence of these scales, the Commission did not recommend a scale because it lacked the necessary data to determine appropriate rates and thresholds. I would suggest a judge would be at a similar disadvantage.

The data and analytical task is quite complex and it would be desirable to have a uniform national scheme if only because of the costs that might be involved could be prohibitive for smaller jurisdictions. It would be preferable for an expert group to establish the scales and also the data set required to inform improved arrangements over time and for the scale to perhaps be reviewed every five years – perhaps this could be a joint project for the Commission and the ALRC.

If parties wish to enter into an arrangement outside that generally determined then application could be made to the Court for assessment on the basis of predetermined criteria.

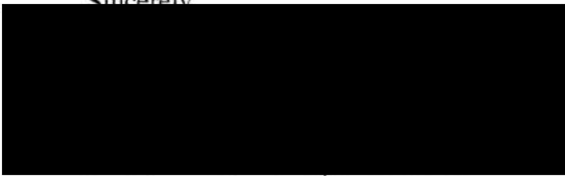
Having reflected on this issue over the four years since the Inquiry, if the approach above was adopted I think it would be desirable for it to apply to all clients, that is, I would not exempt sophisticated clients from its application. This would enhance the data available for the calibration exercise. However, I think it would be appropriate to review outcomes after a five year period to see if there was a need for caps for sophisticated clients to continue.

Consistent with the Commission's view that contingency fee providers would provide some competitive tension to litigation funding, a similar arrangement should apply to both forms of financing as suggested in Proposal 5-3.

Finally I should add that the views expressed in this submission are my own and should not be attributed to the Productivity Commission or any other organisation I am associated with.

Please do not hesitate to contact me if I can further assist with the ALRC's important work.

Sincerely



Dr Warren Mundy FRAeS FAICD