Burford

28 June 2021

Manager
Market Conduct Division
The Treasury
Langton Crescent
Parkes ACT 2600

By email: MCDLitigationFunding@treasury.gov.au

Dear Manager,

Re: Burford Capital submission responding to consultation paper proposing a cap on law firm and funder fees in Australian class actions

Burford Capital welcomes the opportunity to respond to the Consultation Paper dated June 2021 of the Australian Government, Treasury, and Attorney-General's Department (**Consultation Paper**), regarding a proposal to cap law firm and funder fees in Australian class actions.

The bottom line is that capping fees will injure Australian consumers and shareholders, because cases, if prosecuted at all, will settle below their fair value instead of being litigated to maximize recovery. What is most alarming about this proposal is that it has been driven absent any data or case law to support the view that Australian courts are approving class action settlements that are not reasonable, proportionate and fair. A wealth of Australian case law contradicts this baseless conclusion and highlights the important role Australian courts play in reviewing, revising and approving settlements on a case-by-case basis. Furthermore, contrary to the Australian Government's assumption, no informed stakeholder will dispute that the costs and risks associated with the prosecution of Australian class actions has increased in recent times. Australian access to justice and standards of corporate governance have been the envy of the world - the Australian Government should not undermine this by enacting policy that will harm Australian consumers and shareholders.

Burford Capital is the world's largest legal finance provider, publicly traded on the New York and London Stock Exchanges, with a multi-billion-dollar portfolio of litigation and arbitration matters. Whilst Burford's core business, including in Australia, is the funding of large commercial claims for corporate clients, we have a deep understanding of class action regimes across the globe, and how such actions are prosecuted and funded, because of our close relationships with many of the world's largest institutional investors and law firms. Burford's focus in Australia will remain on corporate claims and not class actions and we do not propose to obtain an Australian Financial Services Licence. As such, Burford is a dispassionate but expert observer willing to offer some thoughts as Australia considers various changes to its class action regime and laws governing such actions.

Fundamentally, the proposals to cap law firm and funder fees in class actions and guarantee a minimum return of class action proceeds to class action members are a wrong-headed way of trying to achieve the goals claimed for the reasons explained below.

Level 19
1 O'Connell Street
Sydney NSW 2000

+61 2 8607 8891
mlee@burfordcapital.com
www.burfordcapital.com

The prior ALRC report rejected statutory caps

As a threshold matter, it should be noted here that an analysis of statutory limitations on contingency fee arrangements and commission rates was included in the Australian Law Reform Commission's Final Report 'Integrity, Fairness and Efficiency–An Inquiry into Class Action Proceedings and Third-Party Litigation Funders' (December 2018). The ALRC's analysis focused on potential conflicts of interests for Australian law firms and what restrictions should be imposed on *law firm* contingency fee arrangements and commission rates if they are permitted to charge contingency fees in Australia. The ALRC asked two questions on this subject. *First*, Question 5-2 asked whether there should "be statutory limitations on contingency fee arrangements and commission rates, for example: Should contingency fee arrangements and commission rates also be subject to statutory caps that limit the proportion of income derived from settlement or judgment sums on a sliding scale, so that the larger the settlement or judgment sum the lower the fee or rate? or Should there be a statutory provision that provides, unless the Court otherwise orders, that the maximum proportion of fees and commissions paid from any one settlement or judgment sum is 49.9%?" *Second*, Question 5-3 asked whether there should be "any statutory cap for third-party litigation funders be set at the same proportional rate as for solicitors operating on a contingency fee basis, or would parity affect the viability of the third-party litigation funding model?"

Burford's submission to the ALRC agreed with the ALRC's overarching desire to ensure that law firms and funders work with clients in ways that are fair and equitable, but underscored that both Question 5-2 and 5-3 should be answered in the negative because rigid arbitrary caps are not necessary or productive.

Burford noted that federal and state courts in Australia have demonstrated ample power to supervise commission rates and effectively choose a rate by approving a particular funding package in the case of common fund orders. Likewise, Australian courts have exercised powers to review and revise legal fees in instances where such action is necessary in a case. Furthermore, Burford noted that it is unwise to confer on the courts price-setting powers embodied in legislation when case law already provides adequate supervision. This is an area the courts and judicial practice has wisely eschewed, and to force price-setting restrictions on the courts would take Australia away from the mainstream and effect no further useful purpose beyond what is already achieved by existing judicial supervision.

Burford also noted that it is not necessary or advisable for the ALRC to engage (or suggest the government engage) in arbitrary price-setting by establishing statutory caps and commission rates for law firms or funders. Burford underscored that setting caps may seem to offer protection, but in practice, it will narrow the marketplace of law firms and funders and thus limit the choices and flexibility that should be afforded to Australians. This point is just as relevant today at a time when data indicates that funded class actions have decreased from 75% of class actions in 2017 to 46% in 2021.

Furthermore, Burford referred the ALRC to the successful precedent offered by the Association of Litigation Funders of England and Wales, whose Code of Conduct does not set caps but does make clear that funders may not recoup more than is agreed upon in advance by the client. According to the Code of Conduct, a funder "receives a share of the proceeds if the claim is successful (as defined in the LFA [litigation funding agreement]); and does not seek any payment from the Funded Party in excess of the amount of the proceeds of the dispute that is being funded, unless the Funded Party is in material breach of the provisions of the LFA."

Burford suggested that the ALRC will have a more positive impact on protecting clients and law firms that utilise funding by emphasising the need for professional funding agreements that clearly communicate financial obligations by all parties. A client may consider such an agreement against other competing offers and make a decision about the best possible funding arrangement on that basis. Corporate clients are sophisticated parties that will enter into such agreements with professional counsel. In the current class action regime, the financial obligations of class members to law firms and to funders are already subject to judicial review and approval, and we trust that this process will result in the best outcome for Australians.

Consistent with Burford's specific submissions on this point, the ALRC did *not* recommend that any form of statutory cap be implemented on law firms or funders. Rather, the ALRC recognized the primacy of the role of the Federal Court in reviewing, revising, and approving all fees at the time of settlement approval on a case-by-case basis.

The new proposal of an arbitrary 30% cap on law firm and funder fees should also be rejected

Burford does not take a policy view about the proper scope of class actions in Australia. Each jurisdiction must make its own choices about the best model for group redress; those models could include regulatory activity in addition to judicial relief. If, however, class actions are going to be used in a jurisdiction to provide group redress, presumably the goal of a fair-minded justice system is to deliver to class members a resolution that maximizes their compensation for injury.

Like most forms of arbitrary price controls, the proposal of a cap is a wrong-headed way of trying to achieve the goals claimed, and indeed will have unintended adverse consequences for Australians.

First, the 30% cap has no data or empirical backing to explain how it was arrived at and why it is appropriate—across different types of class actions—given the evolving risks associated with prosecuting class actions in Australia. In fact, the proposal in the Consultation Paper to set a cap at 30% and then potentially ratchet that percentage *down* via a "graduated approach" in purportedly *less risky* cases to "take into account the risk, complexity, length and likely damages award or settlement to flow from a case" highlights why an arbitrary and rigid statutory cap untethered from the risks of a specific case is not only inappropriate but also destined for failure. Such a "graduated approach" could equally be applied to justify law firm and funder fees that exceed 30% of any recovery, especially given the costs and risks associated with prosecuting class actions in Australia. The ALRC recognized this point by acknowledging:

> *Sliding scale statutory caps may result in payments disproportionate to work or risk. This risk could run both ways—limitations on income may not accurately reflect the true extent of the work or risk, leading to solicitors being under or overpaid. In this way, caps may be too blunt an approach that does not allow for differences of risk in individual cases.*

(Internal citations omitted). Furthermore, there is no basis for regulating from the assumption--contained in the Consultation Paper--that the funding of class actions has become *less risky* in an environment where more class actions are now being prosecuted through trial and more costs and risks accompany the prosecution of class actions, including but not limited to the substantial additional costs and risks that flow from the Government's new funder regulations for class actions (which were implemented prior to any public consultation and have been widely recognized as not being fit for purpose) and the varying approaches that Australian courts have taken on key class action issues like carriage disputes, security for adverse costs, common fund orders, and class closure.

Second, the economic impact of any such cap will be to undermine adequate settlement offers and so make many class actions uneconomic to fund. The objective of maximizing compensation for injury is not achieved by setting minimum thresholds of recovery for class members or maximum levels of compensation for lawyers or funders. The problem with such an approach is that it begins with an artificial denominator – that of the amount a party is going to pay. In a system where funders are liable for adverse costs should a case go to trial and lose, and where their upside is limited, the natural incentive being created is for cases to settle, and to settle for less than their full value because the risk of pressing for a higher settlement creates trial risk. Thus, this approach will ensure smaller denominators – smaller settlements to be carved up.

Australia has already seen this phenomenon without any limits on funder compensation: virtually all Australian class actions settle before trial because the risk of adverse costs exposure makes it too risky for parties to go to trial. A further constraint such as that proposed will simply lower further funders' risk tolerance. Suppose the potential damages in a case are $20 million, litigation costs are $3 million per side to go through trial, and the funder is entitled to 3x its invested capital in the case. A funder is risking $6 million by going to, or close to, trial (which is the way to maximize class recovery). If the case loses, the funder will lose $6 million. If the case wins, the funder will be paid $9 million and the class will receive $11 million. That is appropriate compensation for risk and a good recovery for the class. If, however, the funder's recover were capped at 30%, the funder would receive $6 million in exchange for risking $6 million. No rational economic actor will do that. Instead, with a 30% entitlement, the funder will endeavor to settle as rapidly as possible, before it has spent much money. So, a funder will accept a low $7 million settlement after spending only a few hundred thousand dollars, pocket a profit of almost $2 million, and the class will only yield $4.9 million – less than half of the alternative scenario. That is bad policy and the proposals under consideration are going down the wrong path in terms of class action regulation.

Third, whilst any cap will impact both law firm fees and funder fees in Australian class actions, there is no explanation provided in the Consultation Paper why the primary focus appears to be on funder returns. This is in stark contrast to the ALRC Report, which only considered potential caps in the context of trying to regulate Australian law firms that seek to charge fees on a contingency fee basis. As noted above, the basis for the ALRC and Productivity Commission focusing on law firms was because of potential conflict issues that funders are, by definition, not subject to. With Australian law firms running cases on a "no win no fee" basis and now being able to seek Group Cost Orders in class actions filed in Victorian Supreme Court (that allow law firms to seek a contingency fee), it is not clear why the Australian Government has not sought to regulate Australian law firms and funders in a consistent and coherent manner, especially at a time when Australian courts have recently been directing much closer scrutiny towards the legal fees charged in class actions. The Australian Government appears to be inadvertently creating regulatory and licensing barriers, and disclosure obligations, that apply to funders but not law firms without any analysis of what consequences and impacts such differential treatment will have on the class action market. This approach also contradicts the Government's long-held opposition to law firms charging contingency fees.

Fourth, as noted above, no evidence has been provided to suggest that Australian courts have had any issue exercising their current powers to scrutinize, review and approve proposed settlements in Australian class actions, including the fees claimed by law firms and funders, and make nuanced assessments on a case-by-case basis. Indeed, the ALRC Report cited numerous submissions, including from the Law Council of Australia, the Australian Bar Association, plaintiff and defense law firms, academics, and funders, stating that the "primary reason advanced against statutory caps, however,

was that the Federal Court—especially in relation to the model proposed by the ALRC—has sufficient power and oversight to contain percentage-based fees to proportional and appropriate amounts. This reflects the recommendations of the VLRC which found that court determination of the percentage fee meant that statutory caps were unnecessary" (internal citations omitted).

Against this near unanimous historic opposition to the imposition of a cap on law firm and funder fees in class actions, the U.S. Chamber of Commerce is aggressively lobbying for an arbitrary cap. This is hardly a surprise: the result is a fundamental shift away from compensating class members adequately. To use the example above, the defendant will of course prefer a $7 million settlement to a $20 million judgment. In fact, this approach essentially aligns funders and corporate defendants at the expense of compensation for class members. Why is it that Australia seems to be listening – or indeed kowtowing – to this American lobby group, with its nakedly anti-litigation agenda?

If the policy goal is to harm Australian consumers and the shareholders of Australian companies, this is a good plan. If the goal is to maximize compensation for injury, it misses the mark badly.

Sincerely,

Craig Arnott

Deputy Chief Investment Officer
Burford Capital

Matt Lee

Principal, Sydney
Burford Capital