CLASS ACTIONS AND LITIGATION FUNDING IN AUSTRALIA - AN UPDATE

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The Inquiry:

On 21 December 2020, the Parliamentary Joint Committee on Corporations and Financial Services handed down their 454 page report "*Litigation funding and the regulation of the class action industry*" (**the PJC Report**)[1]. This followed an extensive consultative inquiry (**the PJC Inquiry**); comprising over 100 submissions from industry stakeholders and 5 public hearings conducted throughout July and August 2020. Central to the PJC Inquiry was the recent substantial growth in class action activity across Australia, particularly shareholder claims, and the evolution of the litigation funding market in Australia, which had seen a marked increase in participation of international players, and a trend towards increased profits. A key focus of the PJC Report was the need to increase the transparency of the litigation funding market.

The PJC Report detailed 31 recommendations. The Australian government continues to consult on these recommendations and has committed to respond fulsomely in 2021.

Litigation Funding in Australia: A Changing Landscape

Regulatory Reform

In response to concerns over a perceived lack of regulation of the Australian litigation funding market (and, more significantly, the rising numbers of funded class actions), and prior to the PJC Report's publication, the Government legislated to require funders to obtain an Australian Financial Services License (**AFSL**), and be subject to the managed investment scheme regulatory regime in the *Corporations Act 2001* (**MIS Regime**).

These reforms commenced on 22 August 2020. Funders have been slow to obtain an AFSL, with only a small proportion having done so, indicating uncertainty and suggesting that many funders intend to exit the Australian market or have already done so.

The Australian Securities and Investments Commission (**ASIC**) has, to date, issued two relief instruments:

1. Relief for responsible entities of funding managed investment schemes from certain requirements (such as the requirement to give product disclosure statements to passive general members); and
2. Relief from the obligation to regularly value scheme property.

ASIC has also released a consultation paper offering guidance regarding the MIS Regime for litigation funding schemes and has also foreshadowed that further relief will be made available.

1 https://www.aph.gov.au/Parliamentary_Business/Committees/Joint/Corporations_and_Financial_Services/Litigationfunding/Report

A number of submissions to the PJC Inquiry emphasised concerns that the MIS Regime was not fit for purpose in the context of litigation funding. Recommendation 28 of the PJC Report called on the Australian government to legislate a fit-for-purpose MIS Regime, tailored for litigation funders. We are yet to see any developments to this end.

Already, the impact of increased regulation of the funding market has had visible results, including a substantial decrease in the number of class actions funded by litigation funders. In 2019, 59% of class actions were known to have received third party funding. In 2020 that figure had reduced to approximately 33%.

Continuous Disclosure

Recently, on 11 August 2021 the Australian government passed legislation to make permanent changes to Australia's continuous disclosure laws, as per Recommendation 29 of the PJC Report. *The Treasury Laws Amendment (2021 Measures No. 1)* Bill received Royal Assent on 13 August 2021 and amends the provisions of the *Corporations Act 2001* regarding continuous disclosure obligations. The amendments introduce a fault element so that companies and their officers will only be found to be in breach of their obligations, if they act with "knowledge, recklessness or negligence" in disclosing or failing to disclose information which would have a material effect on the price or value of a company's share price.

The introduction of a fault element brings Australia's continuous disclosure regime closer to that in England. The justification for the changes is to provide companies with increased confidence to disseminate company updates and forecasts of future earnings made on reasonable bases to shareholders, as the risk of class actions being brought against them has been mitigated. This development is predicted to ultimately decrease the number of shareholder class actions brought in Australia.

Caps on Returns

Recommendation 20 of the PJC Report proposed the introduction of a guaranteed minimum rate of return for class action members, for the purpose of ensuring successful class members receive adequate compensation. The PJC Report recognised, however, that any reforms would need to ensure that funders receive reasonable returns.

Significantly, on 30 September 2021, the Australian government introduced the *Treasury Laws Amendment (Measures for Consultation) Bill 2021: Litigation funders (***The Bill***)*. The Bill creates a rebuttable presumption that any return of class action proceeds to group members that is less than 70% of the total proceeds is not fair or reasonable. This is notable given that, historically, on average, 41% of total proceeds in such matters have gone to lawyers and funders.

The 30% minimum return has already proven controversial. Research commissioned by funder Omni Bridgeway and undertaken by PWC concluded that the proposed 30% cap will result in 36% fewer class actions. If brought into law, the reforms will significantly reduce class action activity in Australia.

Looking forward:

The class action and litigation funding landscape in Australia remains fluid, as industry and government strive for an approach that adequately balances considerations of facilitating access to justice, containing litigation risk for companies, ensuring adequate returns for litigants, and regulating an historically opaque industry.

It remains to be seen whether Australia will eventually have a fit for purpose regime to regulate funders, whether the proposed 30% cap on funder profits will be enacted and, of course, what the market response to the cap on profits will be.

As we are now in the final quarter of 2021, achieving certainty on the outcomes of the PJC Report this year seems ambitious. This lack of certainty, escalating regulatory costs, together with the proposed cap on returns, may keep many funders at bay, potentially – and counter-productively – decreasing competition in the Australian market, increasing the cost of funding and curtailing access to justice.