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Litigation funders hit the jackpot at the expense of consumers

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While most Australians were enjoying the last few days of the summer break, the federal government quietly released the Australian Law Reform Commission's report into class actions and the litigation-funding industry. What little attention it received was quickly swamped by the release of the banking royal commission's final report.

It's not surprising the government effectively buried the report. While plaintiffs' lawyers and litigation funders celebrated, the report offers little for consumers or the wider community.

In broad terms the ALRC was tasked to consider three key issues. The regulation of the litigation funding industry, the management of class actions and the merits of lifting the prohibition on lawyers charging contingency fees.

Previous inquiries, including those by the Productivity Commission and the Victorian Law Reform Commission, had recommended the litigation-funding industry be regulated federally through a licensing regime.

The ALRC's own consultation process recognised the need for regulation, as did 80 per cent of the submissions it received in response to its discussion paper. They wanted effective oversight. This is hardly surprising.

The litigation-funding industry is awash with conflicts of interest, consumers have next to no power to negotiate terms while funders unilaterally impose fees and charges which, in some instances, are simply exorbitant.

The ALRC suggested that ASIC or APRA regulate the industry. The regulators were unusually active and persuasive in their response and appear to have convinced the ALRC they couldn't

possibly regulate the 25 odd funders that make up Australia's litigation-funding industry.

This is an extraordinary proposition and one the ALRC should have rejected out of hand.

However, rather than recommend strong oversight and the effective regulation of the litigation-funding industry, the ALRC has chosen to leave the task of protecting consumers to the plaintiffs' lawyers, the intermediaries, who rely on the funders to pay their fees and to the Federal Court.

This is a flawed solution for many reasons. First, as commissioner Kenneth Hayne powerfully observed in his final report: "The interests of client, intermediary and provider of a product or service are not only different, they are opposed. An intermediary who seeks to stand in more than one canoe cannot.

"Duty (to client) and (self-) interest pull in opposite directions. Experience shows that conflicts between duty and interest can seldom be managed: self-interest will almost always trump duty."

Second, many class actions are run in state courts where the Federal Court has no jurisdiction. The ALRC's proposal to extend the Federal Court's supervisory role will do nothing to assist consumers in the NSW, Victorian and West Australian courts.

This, coupled with the recommendation that all class actions be run on an opt-out basis, will encourage forum shopping. Funders and plaintiffs' lawyers will start proceedings in the court that best suits their business model.

The Australian litigation-funding industry is a national industry. The ALRC was charged with finding a national solution and has demonstrably failed in that task.

At the same time the ALRC recommended that the longstanding prohibition on plaintiffs' lawyers charging contingency fees, that is a percentage of the compensation the client receives, be removed in class actions.

This change, coupled with common fund orders, will allow plaintiffs' lawyers to unilaterally charge every class member a percentage of any settlement or judgment without the consumers' agreement or consent.

Indeed, in many cases the consumer won't even be aware that their lawyer will take a significant part of their compensation.

The banking royal commission exposed the awful consequences of the failure of regulation in one part of the financial services industry.

Yet, despite the frightening similarities in terms of conflicts of interest and the imbalance of power between funder and consumer, the ALRC seems to believe the litigation-funding industry is somehow different.

It seems to believe that self-interest will be set aside and consumers protected by intermediaries who are themselves dependent upon the very entities from whom they are meant to protect consumers.

It also seems to believe that funders will comply with ASIC guidance notes, despite the fact that there is no regulator that is actually responsible for policing the industry.

As Hayne observed: “Misconduct will be deterred only if entities believe that misconduct will be detected, denounced and justly punished.”

Finally, the ALRC appears to believe that increasing the power of the Federal Court to supervise class actions will influence the approach of state courts.

The evidence is overwhelming. The litigation-funding industry is no different to other sectors of the financial services industry. Reform is overdue and consumers can only hope that whichever party takes power after the federal election heeds the words of Hayne and delivers strong oversight and the effective regulation of the litigation-funding industry.

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