FCAI Submission in relation to the Treasury Laws Amendment (Measures for Consultation) Bill 2021: Litigation funders

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FCAI Submission to Litigation Funding Inquiry

1. Executive Summary

1.1 The Federal Chamber of Automotive Industries (**FCAI**) is the peak industry organisation representing the importers of passenger vehicles, light commercial vehicles and motorcycles in Australia. The FCAI welcomes the opportunity to make this submission in relation exposure draft of the Treasury Laws Amendment (Measures for Consultation) Bill 2021 (the Bill) related to the proposed regulation of litigation funding.

1.2 FCAI members have been subject to a number of recent class actions supported by litigation funders, including one where at the point of approving settlement the Court held that the Funder in question had during the course of the proceeding engaged in "*entrepreneurial activity entered into solely for the financial benefit of [the Funder] and in complete disregard of the interests of group members*."[1]

1.3 FCAI accepts that litigation funding has a role to play in the Australian class action landscape to facilitate the efficient resolution of multiple claims arising from the same, similar or related circumstances. However, it strongly supports appropriate regulation of the industry through legislation to ensure that litigation funders are exposed to appropriate levels of risk in relation to the litigation they support. Ensuring that litigation funders are exposed to appropriate levels of risk in relation to their funding will help to limit the exposure of FCAI members to speculative litigation which does not have a significant level of support among potential claimants.

1.4 FCAI therefore welcomes the Bill as an important next step in the regulation of litigation funders and empowering Courts to ensure that funders returns are limited to what is appropriate in the specific circumstances of the case.

1.5 FCAI's Submission is structured to:

(a) provide some background for the Committee on FCAI and the Australian automotive industry;

(b) highlight certain areas of concern for FCAI members which mean that the FCAI supports most of the content of the Bill; and

(c) identify some residual concerns which the FCAI has in relation to the Bill.

2. FCAI and the Australian Automotive Industry

2.1 Size, Shape and Importance to Australia

(a) In the 2019 calendar year, there were 1.06 million new vehicles sold in Australia out of a total estimated 91 million sales worldwide.[2] There are currently over 18 million vehicles on Australia's roads, meaning that the Industry plays an essential role in the work and social lives of most Australians.

(b) With the closure of the last major Australian vehicle manufacturing plants in late 2017, all vehicles sold by FCAI member organisations are now imported into Australia. However, while manufacturing no longer occurs in Australia, FCAI member organisations employ approximately 60,000 Australians across a number of roles, both directly and indirectly. Further, many automotive brands are major

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[1] Cantor v Audi (No 5) [2020] FCA 637 (***Cantor***) at [472].

[2] International Organization of Motor Vehicle Manufacturers, 2005-2019 Sales Statistics http://www.oica.net/category/sales-statistics/; FCAI, 'New vehicle sales down in challenging 2019 market' (6 January 2020) https://www.fcai.com.au/news/index/view/news/600.

providers of specialist training for automotive technicians who may diversify into other industries.

2.2 **Automobiles, Recalls and the ACL**

(a) Motor vehicles and motorcycles are extremely advanced consumer goods made from tens of thousands of component parts (which themselves are made by hundreds of separate manufacturers from around the globe). The mechanical, chemical and computer technology contained within vehicles, and the way that this technology interacts with the driver, other drivers and pedestrians, communication systems and the external environment, is evolving at a rapid rate as the benefits of these new technologies to society becomes more readily identifiable.

(b) The advanced and complex nature of motor vehicles, coupled with the nature of their use, means that they require routine inspection, servicing, and repair or replacement of component parts. As a result:

(i) new motor vehicles are generally supplied with express warranties in addition to those contained in the Australian Consumer Law (**ACL**);

(ii) regular servicing is required; and

(iii) safety recalls are common - approximately one-third of all voluntary recall notifications in the 2018 and 2019 financial years related to motor vehicles (not including those relating to Takata airbags).[3]

(c) FCAI has worked with the Industry and Government to develop a Code of Practice for automotive safety recalls which recognises not only the particular complexities associated with motor vehicles but also the ability to trace each individual unit of product in the market.[4] It is also important to note that the initiation of a recall, particularly in relation to a motor vehicle does not mean that the issue identified as the basis for the recall gives rise to a consumer remedy under the ACL. Rather it results from the identification of a risk higher than that entertained at the time of release of the vehicle to market. It may be that the recall is precautionary, so that the risk is later shown not to exist. It may be that the issue which gives rise to the recall only actually affects a small fraction of the vehicles recalled. It may also be that the appropriate ACL remedy is repair of the goods at no cost to their owner, which is achieved by the recall in any event.

(d) In addition to the protection afforded by express warranties and voluntary safety recalls, the ACL creates a regime which supports the rights of Australian consumers. In the context of the automotive industry, this means that consumers are able to have their vehicles campaigned by dealers to ensure continuous product improvement or that the potential problem is eliminated. Further, in the case of complex products like motor vehicles, the ACL creates a delicate balance between recognising the inevitable need for service and repair over a lengthy operating life and providing additional remedies to consumers in rare cases of serious product failure. Whether the ACL strikes the right balance in the case of motor vehicles is a matter of ongoing dialogue between the FCAI and the government.

(e) It is important that FCAI members are able to promptly and transparently communicate to the market in respect of potential safety issues. This is critical for products such as motor vehicles. No FCAI member wants to see a user of their vehicles affected by a safety issue. However, the FCAI is concerned that its members are not subject speculative class actions claiming economic loss

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[3] ACCC and AER, Annual Report 2017-18, 113: https://www.accc.gov.au/system/files/ACCC-%26-AER-Annual-Report-2017-18_0.pdf; ACCC and AER, Annual Report 2018-19, 106: https://www.accc.gov.au/system/files/ACCC-AER%20annual%20report_2018-19.pdf.

[4] The current edition, FCAI, Code of Practice for the Conduct of an Automotive Safety Recall (17 October 2019), may be found at:: https://www.fcai.com.au/news/codes-of-practice/view/publication/86.

emerging from recall announcements, particularly if the recall offers a complete remedy for the issue for the vast majority of, if not all, vehicle owners.

2.3 **Recent Class Actions Affecting the Industry**

(a) In recent years, several FCAI members have been the subject of significant class action proceedings - all but one of which have been commenced following a vehicle safety recall or customer service exercise by the member company. Broadly speaking, a customer service exercise involves the member company inviting consumers to obtain a non-safety related field fix or product improvement (such that it is not considered to be a safety recall).

(b) In the cases following recall or customer exercise, the claim brought on behalf of group members includes a claim that the relevant recall or exercise (or the issue underlying the recall or exercise) has caused affected vehicles to lose value and that group members are entitled to be compensated for that loss in value.

(c) Each of these proceedings has attracted significant media attention. They also demonstrate that class actions involving large classes and complex technical issues can take many years from commencement to hearing or settlement:

(i) **Volkswagen Diesel Emissions:** Five class actions were commenced in late-2015 on behalf of 100,000 Australian car owners against Volkswagen, Audi, and Skoda, in relation to breaches of the ACL as a result of dual-mode software in diesel vehicles which had the effect of reducing diesel emissions recorded during emissions tests.

These class actions were brought by two law firms and ran for approximately four years before settlement. The Federal Court approved a settlement of the class actions in 2020 with the Volkswagen Group agreeing without admission of liability to pay group members up to $127.1 million (**Cantor**). One of the law firms was funded by Grosvenor Litigation Services, the other was not funded.

(ii) **Ford Transmission:** A class action against Ford in relation to certain models equipped with the Powershift transmission was commenced in May 2016 on behalf of 70,000 group members, alleging that the affected vehicles are subject to a number of issues including transmission slippage and sudden acceleration. The class action is funded by Martin Place Litigation Services.

The Federal Court delivered its first instance judgment in June 2021[5], more than five years from the date the proceedings were filed. The applicant was successful in respect of some claims and not in respect of others. A claim for damages assessed on an aggregate basis was rejected because the Court held that damages had to be assessed for each individual group member, having regard to among other things, whether Ford had fixed the relevant problems pursuant to an express warranty. We understand that this decision is currently subject to appeal.

(iii) **Takata Airbags:** Class actions were brought against seven car companies. Those actions were filed on a rolling basis commencing in November 2017 on behalf of an estimated 2.3 million group members. These proceedings seek damages for consumers who purchased vehicles fitted with certain Takata airbags sold by Toyota, Honda, Mazda, BMW, Subaru, Nissan and Volkswagen, from 2002 through to 2015. The proceedings have a common law firm and funder.

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[5] *Capic v Ford Motor Company Of Australia Pty Ltd* [2021] FCA 715

Six of these proceedings have been settled in principle, and the NSW Supreme Court has recently ordered a registration process for group members[6], with a settlement approval hearing likely to occur in February 2022. The settlement is for $52 million across all six proceedings, with the funder seeking $13 million by way of funding commission (approximately 25%) and the plaintiffs seeking $15.3 million by way of costs (approximately 29%).

The seventh proceeding, *Dwyer v Volkswagen Group Australia Pty Ltd*, proceeded to a hearing in May 2021, at which Volkswagen was entirely successful[7]. We understand that this decision is also subject to appeal.

(iv) **Toyota Diesel Particulate Filter:** Class action proceedings were commenced by two law firms, supported by a litigation funder, in July 2019 against Toyota on behalf of approximately 265,000 consumers who purchased various models fitted with diesel particulate filters which are alleged to be faulty and were subject to a customer service exercise.

These proceedings are ongoing.

(d) In addition to the actions outlined above, a number of other class actions have been threatened against FCAI members. The threats follow a similar structure to those outlined above, namely that they allege that vehicles which have been subject to remedial action by the local owner have nevertheless lost value because of the presence of an alleged defect in the vehicle or caused other out of pocket losses.

3. The FCAI supports the Bill

3.1 In its June 2020 submission to the Parliamentary Inquiry into litigation funding, the FCAI expressed its view that litigation funding arrangements should be regulated so as to ensure that class actions continued to fulfil the original purpose of access to justice and the vindication of group member rights and did not service the commercial interests of litigation funders.

3.2 The FCAI also expressed the view that all parties' interests (including the Courts) will be assisted by certainty as to what is and is not permissible (or what is and is not required) when it comes to:

(a) funding arrangements (including but not limited to the commercial return a funder can achieve from their investment, and the circumstances in which a funder can withdraw funding from a proceeding they have caused to be commenced);

(b) the prudential requirements imposed on a funder in order that they are able to meet the ongoing costs of the class action, any security for costs ordered and any adverse costs order; and

(c) orders or steps that might assist in the just, quick and cheap resolution of funded class actions.

3.3 The Bill is directed at addressing the first of these points. It provides for a number of matters which must be included in a litigation funding agreement in order for it to be enforceable. It requires that such an agreement be approved by a Court to be enforceable and provides federal courts with express powers to approve such funding agreements.

3.4 Each of these is a desirable change. Taken together these changes clarify what is required of litigation funders and reduce uncertainty in relation to the Court's powers in respect of litigation

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[6] *In re the Takata Airbags Class Actions Settlement (Preliminary Orders)* [2021] NSWSC 1153.

[7] *Dwyer v Volkswagen Group Australia Pty Ltd t/as Volkswagen Australia* [2021] NSWSC 715

funding agreements. Therefore the FCAI supports the Bill, subject to some specific concerns which are raised in section **Error! Reference source not found.**.

3.5 There are other aspects relating to the regulation of litigation funding which were raised by FCAI in its Parliamentary Inquiry submission which are not addressed by the Bill (although some were addressed by the *Corporations Amendment (Litigation Funding) Regulations* 2020 which came into effect in August 2020 and the associated ASIC instrument). The FCAI does not propose to address those additional matters here, except to the extent that they are directly relevant to the Bill. However, the FCAI maintains its position on the matters set out in its submission to the Parliamentary Inquiry.

4. Specific concerns about the Bill

4.1 The requirement that general members agree in writing to participate in a scheme

(a) The FCAI is concerned that definition of "general member" proposed to be inserted into section 9 of the *Corporations Act* 2001 by the Bill may give rise to uncertainties about the group members in funded open class actions.

(b) Australian class action regimes allow for open class actions to be commenced on behalf of group members who do not give their consent[8]. Australian courts have also held that closed class actions are possible where all group members are persons who have signed a litigation funders funding agreement[9]. This can be achieved by making it a condition of group membership that a person has signed a particular funding agreement.

(c) In the FCAI's view open class actions are, generally speaking, preferable. They reduce the risk that multiple class actions will be commenced in respect of the same issue (which tend to add to the cost and inconvenience of defending class actions). They are also less likely to lead to competition between promoters of class actions for group members with the resultant potential for predatory advertising, which may needlessly increase customer anxiety in respect of recall issues in circumstances where FCAI members have those issues well in hand.

(d) The Bill proposes that the general members of a class action litigation funding scheme will be required to give their written consent to be a member of such a scheme (section 6091GA(5)(a)). Conversely, a general member of a scheme is defined in the proposed amendments to section 9 as a person who has a possible legal entitlement to remedies which is being advanced pursuant to the class action litigation funding scheme and who has provided the written consent required by section 6091GA(5)(a).

(e) These proposed amendments leave uncertain the status of a person who may be a group member in a class action, but who has not given their consent to their involvement in the class action (and who may not be aware of its existence). It therefore creates a potential and undesirable inconsistency with the operation of the class action regimes in funded litigation.

(f) The *ASIC Corporations (Litigation Funding Schemes) Instrument* 2020/787 introduced to facilitate the transition of litigation funding arrangements back into the managed investment scheme regime expressly recognises the concept of a "passive general member", which includes a person of the sort described in (e) above. In the FCAI's submission, this concept should also be recognised in the Bill so as not to unnecessarily discourage the commencement of open funded class actions.

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[8] For example, see section 33E of the *Federal Court of Australia Act* 1976 (Cth). Exceptions exist for Commonwealth, State and Territory governments and their agents.

[9] *Multiplex Funds Management Ltd v P Dawson Nominees Pty Ltd* (2007) 164 FCR 275

4.2 **The presumption of a 70% return to group members (s 601LG(5))**

(a) Litigation funders should not be allowed to benefit from windfall profits, particularly in the context of class action litigation. It is the FCAI's view that Courts should be given express powers to make orders to ensure that, whatever the terms of the funding agreement, the remuneration paid to litigation funders in the event of a settlement or successful outcome is commensurate with the investment and risk, and is not excessive. The proposed new Part 5C.7A provides that funding agreements are not enforceable unless approved by a Court. The change is supported by the FCAI.

(b) However, section 601LG(5) also contemplates a rebuttable presumption that a funding arrangement may only approved if at least 70% of the proceeds of a scheme (meaning, in practical terms, a settlement) are paid to group members.

(c) In the FCAI's submission, the proposed statutory minimum return of 70% of settlement monies to group members is not a well-adapted measure to prevent abuses by funders. That is because it is an arbitrary measure which bears no necessary relationship to the actual risk and reward in a particular class action. It also assumes a relationship between the amount invested by the funder in the litigation and the entitlements of group member which may not exist. It therefore carries a risk of unintended consequences.

(d) It is possible that a funder who recovers 30% of the proceeds of a particular class action may still achieve a return which does not justify their investment. Equally, there may be class actions where the ultimate entitlements of group members are ultimately shown to be minimal or non-existent. The question of whether a litigation funder should make a profit from such litigation and, if so at what level, will need to be determined by a Court, but that should not be done by reference to an arbitrary limit on recovery.

(e) At a practical level, the FCAI is concerned that the presumption of a minimum return may result in that minimum becoming the 'norm' and encourage litigation funders to seek remuneration of 30% of the total settlement sum, regardless of the actual amount of capital invested in the proceedings. As it is difficult for litigation funders to predict whether they will be adequately remunerated for their contribution (both in terms of capital and the risks assumed) until the end of a proceeding, it is likely that any settlement negotiations will be driven by the funder's desire to make good their investment. Imposing a maximum 30% return for funders may have the unintended consequence of making the litigation funder's investment a baseline for settlement and, in turn, settlement more difficult to obtain.

(f) Alternatively, if a presumption is to be established, it is matter better deal with in regulations or in ASIC guidance so that it can be more easily amended if it turns out to have unintended consequences.

4.3 **The factors which may be considered by the Court in applying the fair and reasonable test (s 601LG(3))**

(a) The overarching objective of proposed new section 601LG(3) is ensuring that a funding agreement's claim proceeds distribution method, or any variation of that method, is fair and reasonable when considering the scheme's general members as a whole. In making such a determination, a Court must only have regard to the limited and mandatory factors as set out in the proposed new section.

(b) The factors identified in section 601LG(3) are clearly appropriate matters to be considered by a Court. However, in the FCAI's submission, requirement that a Court must only have regard to the factors set out in section 601LG(3) carries a risk of unintended consequences. Class actions are brought in relation to a diverse range of legal claims and the list at section 601LG(3) may not allow for relevant case specific factors to be considered.

4.4 **The continuing uncertainty in relation to common fund orders (CFOs)**

(a) Following the High Court of Australia's decision in *BMW Australia Ltd v Brewster*[10] there has been a divergence of judicial views as to the availability of CFOs at a later stage of class actions (for example, at settlement or after judgment) and whether a different power to that traditionally relied upon in seeking such orders might support them. This is conducive of uncertainty which will exacerbate the concerns expressed above about the potential for unintended consequences of the Bill and therefore is highly undesirable.

(b) The proposed new Part 5C.7A does not clarify this situation. In the FCAI's submission, the proposed reforms should go further and, in particular, the law should be amended to make it clear that the Courts do not have powers to make CFOs (or other arrangements that have the same outcome as a CFO - however described) at any stage of proceedings.

(c) Prohibiting CFOs will assist to ensure that litigation funders must look after their own commercial interests and bookbuild before commencing proceedings, satisfying themselves that there is a genuine public interest in bringing the claim forward, and lessening the likelihood of claims based on speculative theories of loss of value.

(d) If, contrary to (b), CFOs are not prohibited by legislation (and therefore bookbuilding does not occur) then in order to address the issues identified in (c) and provide a degree of certainty for defendants, express powers should be established for courts to make registration and class closure orders in appropriate circumstances, with a view to increasing the prospect of settlement in circumstances where class actions are commenced with large groups in respect of which minimal information is known. Such powers are already available in Victoria under s 33ZG of the *Supreme Court Act 1986* (Vic).

5. **Conclusion**

FCAI is generally supportive of the Bill with some exceptions as raised above. We would welcome the opportunity to expand on this submission and invite you to contact Tony McDonald on 0410 451342 to discuss this further as necessary.

Yours sincerely,

Tony Weber

Chief Executive

[10] [2019] HCA 45.