ALRC Inquiry into Class Action Proceedings and Third-Party Litigation Funders
Submission in Response to Proposals and Questions
on behalf of
International Litigation Partners ("ILP")

1. Introduction to the Inquiry

Proposal 1–1 The Australian Government should commission a review of the legal and economic impact of the continuous disclosure obligations of entities listed on public stock exchanges and those relating to misleading and deceptive conduct contained in the Corporations Act 2001 (Cth) and the Australian Securities and Investments Commission Act 2001 (Cth) with regards to:

- ***the propensity for corporate entities to be the target of funded shareholder class actions in Australia;***
- ***the value of the investments of shareholders of the corporate entity at the time when that entity is the target of the class action; and***
- ***the availability and cost of directors and officers liability cover within the Australian market.***

ILP considers there is currently insufficient empirical data relevant to the policy considerations under examination to provide a reliable basis for change in the law.

This leaves public debate focusing on the public spectre of actions, rather than evidence, driving policy debate. The Productivity Commission raised this concern in 2014: Inquiry Report No 72, Vol 2, 2014. The ALRC, whilst agreeing that public debate about the underlying laws is more appropriate than changing the mechanism by which class actions are prosecuted, acknowledges this evidence-based inquiry is beyond the scope of its current terms of reference[1]. Without an understanding, for example, of the cost to the ASX and market participants of breaches of the continuous disclosure provisions of the Corporations Act and the deterrent effect of class actions, the ALRC is not only unable to focus on the primary issues but could detrimentally affect the enforceability of our laws; a risk with potentially far greater unintended negative consequences than the potential intended gains that may flow from the current inquiry.

ILP considers that the number of securities class actions filed in recent years should not be viewed as indicative of anything other than the number of instances of misconduct by corporate directors and officers. ILP considers the proposed Inquiry's terms of reference to be too narrow in their focus and, in particular, fail to address:

(a) the cost to the ASX and its participants that currently exists when the market protection laws are not enforced;
(b) the current limitations on the enforceability of the laws; and
(c) the potential detrimental effect any changes the ALRC propose may make to enforceability.

There is also limited focus on potential ways to decrease lawyers' fees and disbursements and the time claims take to resolve. Strong demand for funding obtained by parties in litigation is a symptom of the current cost of justice, not the root cause. A focus on how our courts could more efficiently resolve disputes, rather than by preparation for trials that are unlikely to occur, would have been fertile ground for identifying relevant productive reform measures. In particular, ILP

[1] Page 32 of the ALRC Discussion Paper.

notes that the expenditure incurred by lawyers funded by litigation funders is often responsive to interlocutory applications and other steps taken by respondents in proceedings, and thus to focus only upon the former risks only looking at part of the issue. Almost all of the defence costs arising from funded class actions being funded under pre-existing insurance policies, but the quantum of funding defences dwarfs the funding of claims and accordingly has a far greater capacity to adversely affect our courts' capacity to achieve their objectives.

3. Regulating Litigation Funders

Proposal 3–1 The Corporations Act (2001) (Cth) should be amended to require third-party litigation funders to obtain and maintain a 'litigation funding licence' to operate in Australia.

Proposal 3–2 A litigation funding licence should require third-party litigation funders to:

- ***do all things necessary to ensure that their services are provided efficiently, honestly and fairly;***
- ***ensure all communications with class members and potential class members are clear, honest and accurate;***
- ***have adequate arrangements for managing conflicts of interest;***
- ***have sufficient resources (including financial, technological and human resources);***
- ***have adequate risk management systems;***
- ***have a compliant dispute resolution system; and***
- ***be audited annually.***

ILP does not consider that it should be necessary for litigation funders to obtain a licence akin to an Australian Financial Services Licence. (ILP notes that the High Court held in *International Litigation Partners Pte Ltd v Chameleon Mining NL* (2012) 246 CLR 455 no need for an AFSL).

The key interactions of litigation funders with the Australian justice system are already regulated and supervised by the Courts, and so further regulation is not to be justified by reference to the fact that litigation funders are involved in the Court processes. *First*, the Court has power to supervise communications between litigation funders and clients, and potential clients in the context of Part IV proceedings. *Secondly*, the Court supervises the provision of security for costs in litigation, and if adequate security were not to be provided by a particular funder then the action would not continue. *Thirdly*, the lawyers who are funded by litigation funders are already subject to the supervision of the Court, both in respect to the performance of their ethical duties, in respect of their conduct of litigation (Pt VB of the *Federal Court of Australia Act 1976* (Cth)), and in respect of the level of fees they can charge to their clients. *Fourthly*, litigation funders are already subject to the general and statutory law of Australia in dealing with their clients, including the law of contract and laws prohibiting misleading or deceptive conduct, and the Courts can police instances of unsatisfactory conduct within the context of managing any particular litigation in which any such problem were to arise.

There is no evidence that the absence of a licensing system has led to particular problems in the litigation funding market in Australia, or with respect to the conduct of any particular litigation, as the ALRC acknowledges in [3.25].

Apart from arrangements for managing conflicts of interest, ILP does not believe any licensing regime should impose any external supervision on litigation funders with regard to their financial, technological and human resources, risk management systems, capital adequacy, dispute resolution systems and annual audits.

Question 3–3 Should third-party litigation funders be required to join the Australian Financial Complaints Authority scheme?

No. There is insufficient evidence of complaints to date to require joinder of the scheme.

4. Conflicts of Interest

Proposal 4–1 If the licensing regime proposed by Proposal 3–1 is not adopted, third-party litigation funders operating in Australia should remain subject to the requirements of Australian Securities Investments Commission Regulatory Guide 248 and should be required to report annually to the regulator on their compliance with the requirement to implement adequate practices and procedures to manage conflicts of interest.

ILP agrees, and considers that ASIC Regulatory Guide 248 is sufficient.

Proposal 4–2 If the licensing regime proposed by Proposal 3–1 is not adopted, 'law firm financing' and 'portfolio funding' should be included in the definition of a 'litigation scheme' in the Corporations Regulations 2001 (Cth).

ILP agrees.

Proposal 4–3 The Law Council of Australia should oversee the development of specialist accreditation for solicitors in class action law and practice. Accreditation should require ongoing education in relation to identifying and managing actual or perceived conflicts of interests and duties in class action proceedings.

ILP agrees.

Proposal 4–4 The Australian Solicitors' Conduct Rules should be amended to prohibit solicitors and law firms from having financial and other interests in a third-party litigation funder that is funding the same matters in which the solicitor or law firm is acting.

ILP agrees.

Proposal 4–5 The Australian Solicitors' Conduct Rules should be amended to require disclosure of third-party funding in any dispute resolution proceedings, including arbitral proceedings.

ILP does not agree. If the amendment was made, the definition of third-party funding ought to include insurer funding of defence costs.

Proposal 4–6 The Federal Court of Australia's Class Action Practice Note (GPN-CA) should be amended so that the first notices provided to potential class members by legal representatives are

required to clearly describe the obligation of legal representatives and litigation funders to avoid and manage conflicts of interest, and to outline the details of any conflicts in that particular case.

ILP agrees, although is mindful of the need to balance comprehensive disclosure with comprehensibility especially for consumers who may have a tendency not to read what they perceive to be "fine print".

5. Commission Rates and Legal Fees

Proposal 5–1 Confined to solicitors acting for the representative plaintiff in class action proceedings, statutes regulating the legal profession should permit solicitors to enter into contingency fee agreements.

This would allow class action solicitors to receive a proportion of the sum recovered at settlement or after trial to cover fees and disbursements, and to reward risk. The following limitations should apply:

- ***an action that is funded through a contingency fee agreement cannot also be directly funded by a litigation funder or another funding entity which is also charging on a contingent basis;***
- ***a contingency fee cannot be recovered in addition to professional fees for legal services charged on a time-cost basis; and***
- ***under a contingency fee agreement, solicitors must advance the cost of disbursements and indemnify the representative class member against an adverse costs order.***

ILP considers that the current tripartite relationship between solicitors, litigation funders and clients structurally supports the unfettered fiduciary duties which solicitors owe to their clients. ILP opposes the introduction of contingency fees given the conflict of interest it generates. However, if they are introduced:

(a) there needs to be sufficient safeguards to ensure that solicitors' fiduciary duties are not fettered as a result; and

(b) the first limitation noted above ought not operate (as there will be cases where solicitors and litigation funders may be able to share the funding in a way which results in overall better (including cheaper) outcomes

In addition to this, any capital adequacy requirements imposed on funders should also be applied to law firms.

Proposal 5–2 Part IVA of the Federal Court of Australia Act 1976 (Cth) should be amended to provide that contingency fee agreements in class action proceedings are permitted only with leave of the Court.

ILP considers that if contingency fees are permitted, then court oversight of fee agreements charged by officers of the court is appropriate.

Question 5–1 Should the prohibition on contingency fees remain with respect to some types of class actions, such as personal injury matters where damages and fees for legal services are regulated?

ILP has no position on this question.

Proposal 5–3 The Federal Court should be given an express statutory power in Part IVA of the Federal Court of Australia Act 1976 (Cth) to reject, vary or set the commission rate in third-party litigation funding agreements.

ILP does not consider the Federal Court ought to have power to alter contractual arrangements. ILP is aware that there is an ongoing debate about the Court's power to alter contractual rights, and whether s 33ZF and s 33V(2) of the *Federal Court of Australia Act 1976* (Cth) provides statutory warrant so to do, and does not consider it appropriate for the Court to be able to alter freely entered into contracts. Litigation funding is a highly risky form of investment, and the decision to set pricing is often affected by a range of factors associated with the funder's perception of the level of risk associated with the particular case. Presently, the Court can already 'regulate' pricing in open class actions where the litigation funder wishes to obtain the Court's imprimatur to collecting commission from people who have not entered into contracts (by seeking a common fund order). Outside that situation, litigation funders should be able to insist upon its contracts in other contexts given that all the claimants will have signed those contracts (and made a determination to do so, often with third party legal advice, that the return offered by the litigation funder was fair and reasonable in the circumstances, compared to alternative funding offers, if there were any).

If Proposal 5–3 is adopted, this power should also apply to contingency fee agreements.

ILP agrees. Whilst ILP disagrees with pricing regulation, the playing field needs to be the same for all participants.

Question 5–2 In addition to Proposals 5–1 and 5–2, should there 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%?***

ILP does not consider that statutory regulation of pricing is appropriate.

The Australia litigation funding market has until recently had only a few funders and been dominated by IMF Bentham Ltd. The historic structure of the market, which could almost have been considered a monopoly, may have enabled windfall gains, although often simply looking at the matter in terms of absolute return in dollar terms pays insufficient regard to more realistic metrics such as 'Return On Invested Capital', which takes into account the cost of capital.

Further, there are now at least 20 funders operating in the Australian market which is encouraging competition and reduced pricing dramatically. Economic theory is borne out by the recent experience in the GetSwift and AMP shareholder class actions. This has clearly demonstrated the effect of competition so that regulating pricing is no longer necessary. In competitive financial markets, pricing is a function of risk and competition. Any regulation of pricing is likely to have the unintended consequence of encouraging funding for only the strongest or largest cases, which will inhibit a primary policy of encouraging litigation funding to enable access to justice.

Arbitrarily limiting commission to a fixed percentage will not allow an adequate evaluation (without using hindsight) of the appropriate reward for risk.

Question 5–3 Should 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?

ILP is not in favour of any statutory cap, but considers that should they be introduced any statutory cap affecting any component of project costs, being solicitor's fees, disbursements and the cost of an adverse cost indemnity ought to be the same for all service providers.

Question 5–4 What other funding options are there for meritorious claims that are unable to attract third-party litigation funding? For example, would a 'class action reinvestment fund' be a viable option?

ILP does not comment.

6. Competing Class Actions

Proposal 6–1 Part IVA of the Federal Court of Australia Act 1976 (Cth) should be amended so that:

- ***all class actions are initiated as open class actions;***
- ***where there are two or more competing class actions, the Court must determine which one of those proceedings will progress and must stay the competing proceeding(s), unless the Court is satisfied that it would be inefficient or otherwise antithetical to the interest of justice to do so;***
- ***litigation funding agreements with respect to a class action are enforceable only with the approval of the Court; and***
- ***any approval of a litigation funding agreement and solicitors' costs agreement for a class action is granted on the basis of a common fund order.***

ILP does not agree that all class actions should be open-class actions, or that the Court should stay competing proceedings. There will be many situations where a subset of claimants want to be represented by a particular law firm, or funded by a particular litigation funder with whom they have past relationships, or conversely where they do not want to be represented by a particular law firm or funded by a particular litigation funder. Claimants should not be forced into the position where they have to have their claims run by a particular set of lawyers, or funded by a particular funder.

Regardless of whether class actions are commenced as open or closed classes, they do not successfully settle except following a registration process which in effect closes the class and prevents claims being brought by any potential claimant who has not registered. Unregistered claimants remain group members bound by a settlement but disentitled to participate in it. Thus, closed classes have been found to be the only practical way of settling class actions, and the only way of distributing settlement monies is to identify the claimants. Obtaining data from registered group members is often the only way for the lawyers to identify the real strength, and value, of the claims the subject of a class action. In other words, class actions always settle based on an assessment of the value of the claims of registered group members – that is on a de facto closed class basis.

Closed class actions have a proven ability to deliver results (indeed, more so than open class actions), serve a particular market, and should be preserved. There has been no empirical research

into the effect of prohibiting closed classes which would justify their prohibition, and the significant change to the status quo which is involved in that proposal.

The "competing class action" phenomenon has largely been caused by the decision of the Full Court in *Money Max Int Pty Ltd v QBE Insurance Group Ltd* (2016) 245 FCR 191. That decision has led to a race to file proceedings in the hope of gaining a common fund order. This has meant that the time for investigating claims and forming a view on whether they ought to be funded is compressed, litigation funders are discouraged from signing up (or "book building") potential claimants, and potential claimants are discouraged from registering. The absence of large numbers of registered group members (and the removal of incentives to register), actually reduces the ability of those running the class actions to determine whether there is a sufficiently large cohort of interested claimants to make funding the proceeding viable, and also creates the risk of "under-settling" class actions " because those running them do not have sufficient information to be able to work out the true value of claims. The *Money Max* decision is a retrograde step which does not enhance access to justice or improve the operation of the Australian class action system. To entrench the state of affairs it has created by requiring all class actions to be brought as open classes would not improve matters. It should not be the business of the Court to decide which set of lawyers or litigation funder should be permitted to advance all claims, thus depriving claimants of any practical choice in how their own claim is to be dealt with.

The Court will remain able to deal with any abuse of process, or true oppression caused by competing class actions in the ordinary way, though that should not presume the purpose of Part IVA was to ensure there was only ever one proceeding (being an open class action) against a particular respondent. In some circumstances this may involve staying a competing action, but not always.

Proposal 6–2 In order to implement Proposal 6-1, the Federal Court of Australia's Class Action Practice Note (GPN-CA) should be amended to provide a further case management procedure for competing class actions.

If the answer to Proposal 6.1 is yes, then the answer to Proposal 6.2 is also yes. However, as stated above ILP is not in favour of Proposal 6.1.

Question 6–1 Should Part 9.6A of the Corporations Act 2001 (Cth) and s 12GJ of the Australian Securities and Investments Commission Act 2001 (Cth) be amended to confer exclusive jurisdiction on the Federal Court of Australia with respect to civil matters, commenced as representative proceedings, arising under this legislation?

If the answer to Proposal 6.1 is yes, ILP believes a system should be enacted whereby filing a claim first in either a State Supreme Court or the Federal Court of Australia would confer exclusive jurisdiction, but only with the consent of all States, Territories and the Commonwealth.

7. Settlement Approval and Distribution

Proposal 7–1 Part 15 of the Federal Court of Australia's Class Action Practice Note (GPN-CA) should include a clause that the Court may appoint a referee to assess the reasonableness of costs charged in a class action prior to settlement approval and that the referee is to explicitly examine whether the work completed was done in the most efficient manner.

ILP agrees.

Question 7–1 Should settlement administration be the subject of a tender process? If so:

- ***How would a tender process be implemented?***
- ***Who would decide the outcome of the tender process?***

ILP has been involved in cases where the settlement scheme administrators were the class solicitors and in others where they were unrelated third parties. It is ILP's experience that third parties are often more expensive than class solicitors as settlement administrators given that they are new to the proceedings and lack knowledge of group claimant losses. Therefore, ILP considers that in some cases a tender process may be useful, but it ought not be mandatory as in some cases it will be more efficient and cheaper for the class solicitors to deal with settlement administration. The Court (either a judge or Registrar) should determine firstly, if any tender process is required, and second, how it should be run as it will be the Court that ultimately supervises the administration of the settlement.

Question 7–2 In the interests of transparency and open justice, should the terms of class action settlements be made public? If so, what, if any, limits on the disclosure should be permitted to protect the interests of the parties?

All parties receive the benefit of the class action process, with the civil justice system being publicly funded. The information could be collected and made available to form the basis for policy changes in the future. Public disclosure should not be made referable to specific claims, but kept at a macro level in order to maintain the integrity of the settlement process.

8. Regulatory redress

Proposal 8–1 The Australian Government should consider establishing a federal collective redress scheme that would enable corporations to provide appropriate redress to those who may be entitled to a remedy, whether under the general law or pursuant to statute, by reason of the conduct of the corporation. Such a scheme should permit an individual person or business to remain outside the scheme and to litigate the claim should they so choose.

ILP does not comment on this proposal.

Question 8–1 What principles should guide the design of a federal collective redress scheme?

ILP does not comment on this proposal.