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The Hon Justice Sarah Derrington
President
Australian Law Reform Commission
GPO Box 3708
SYDNEY NSW 2001

via email to class-actions@alrc.gov.au

Dear Justice Derrington

Inquiry into Class Action Proceedings and Third-Party Litigation Funders

Thank you for the opportunity to provide a submission to the Australian Law Reform Commission (**ALRC**) Inquiry into Class Action Proceedings and Third-party Litigation Funders.

The Australian Institute of Company Directors (**AICD**) is committed to excellence in governance. We make a positive impact on society and the economy through governance education, director development and advocacy. Our membership of more than 43,000 includes directors and senior leaders from business, government and the not-for-profit sectors.

The AICD welcomes the ALRC's inquiry into class actions proceedings and third-party litigation funders. The AICD recognises that Australia's class actions framework provides an accessible mechanism for individuals to achieve resolution of disputes and access to justice within Australia's court system. However, the AICD shares the concerns of the ALRC that the regime, particularly relating to securities class actions, is increasingly subjecting companies, and ongoing shareholders, to unintended consequences.

The Discussion Paper raises a number of significant issues relating to the class action regime. However, given our focus on excellence in governance and boardroom practice, the AICD has focused on those proposals and questions which are most relevant to our members.

1. Executive summary

In summary, the AICD:

- Strongly supports Proposal 1-1 of the Discussion Paper. A review presents an important and timely opportunity to consider whether Australia's continuous disclosure regime and its operation with misleading and deceptive conduct provisions and the existing class action regime are operating as intended. The AICD strongly

supports continuous disclosure obligations as a vital component of robust disclosure and governance practices to deliver market integrity and investor confidence. However, we share the ALRC's concern that the 'peculiar characteristics' of Australia's statutory provisions (compared with other common law jurisdictions) are leading to adverse and unintended consequences (see **Section 2**).

- Strongly supports Proposal 3-1 and 3-2 to introduce a comprehensive licensing regime in Australia for third party litigation funders. The AICD endorses the model put forward by the ALRC as the best method of achieving this policy objective (see **Section 3**).
- Does not support Proposal 5-1. The AICD is of the view that existing fee mechanisms provide a sufficient degree of flexibility in relation to legal fees to promote access to justice and is concerned that contingency fees may further exacerbate the problems with the current class action regime (see **Section 4**).
- Supports Proposal 6-1 and 6-2, which would enable courts to efficiently address the issue of a competing class action in a way that would accord with the interests of justice (see **Section 5**).

2. Review of impact of legal and economic impact of Australia's continuous disclosure regime

The provision of meaningful and timely disclosure to a market operator is critical to the integrity and efficiency of Australia's capital markets. However, the AICD is concerned that Australia's current continuous disclosure regime, and the provisions relating to misleading or deceptive conduct, are not operating as intended, and are driving several undesirable and unintended consequences.

Currently, s 674 of the *Corporations Act 2001* (Cth) (**Corporations Act**), in conjunction with the civil penalties regime in the Corporations Act, provides for a right for any person who suffers loss as a result of a contravention of the continuous disclosure requirement in ASX Listing Rule 3.1 to seek compensation from the relevant listed company and any person involved in the contravention. Similarly, section 1041H of the Corporations Act provides the legal gateway for a damages claim for misleading or deceptive conduct under s 1041I of the Corporations Act.

The provisions which underpin many securities class actions were introduced in the early 1990s, flowing from the Corporate Law Economic Reform Program initiative. Since then, parameters around enforcement and remedies have shifted, including as a result of the advent of shareholder class actions and the rise of commercial third-party litigation funders. Now, Australian listed companies and directors can face a real threat of securities class actions whenever there is a significant shift in the company's share price.

This is of particular concern given that liability relating to breaches of continuous disclosure requirements, or misleading or deceptive conduct, does **not** require any proof of intention,

recklessness or negligence, meaning that these types of claims can be difficult for companies to defend, notwithstanding the company (through its directors) may have acted honestly and reasonably.

The Australian Securities and Investments Commission (**ASIC**) has frequently acknowledged the difficulties associated with continuous disclosure issues. John Price, ASIC Commissioner, has stated that "we recognise that continuous disclosure issues can sometimes be difficult. Judgment calls can be required by the board. Our decision to take enforcement action against a company and its officers for a continuous disclosure breach is not made lightly."[1] The same considerations do not play into decisions to commence class action proceedings, which inevitably lead to significant costs being incurred by the company involved, including direct costs in the form of legal fees and indirect costs related to management time at both board and executive level.

As identified by the ALRC, some of the unintended consequences include the following:

- As the ALRC and others have observed, the increasingly active securities class action market is resulting in an unsustainable rate of increase in the cost of Directors and Officers (**D&O**) for all listed companies, with reports suggesting there has been an alarming 200% increase in annual D&O premiums over the last 12 to 18 months, with further increases expected as a result of the Hayne Royal Commission.
- The prevalence of "competing" class actions are driving up the costs of class actions for defendants, and the costs of defending class actions is also increasing.
- There is a perception amongst some directors that it is almost impossible to achieve ongoing comprehensive compliance with the continuous disclosure regime in the current environment.

In addition, while there is a lack of any comprehensive analysis of the extent to which securities class actions cause harm to business, investment, and the economy as a whole in the Australian context, the AICD is concerned that the prevalence of securities class actions, when paired with the peculiar characteristics of Australia's regulatory environment:

- risks causing a net negative impact on the value of the investments of all shareholders in a listed company (including on the class members themselves who remain are continuing shareholders);
- risks having a "chilling effect" on the ability of listed companies to attract investment, both domestically and from overseas markets, or to engage in mergers & acquisitions activity;
- causes difficulty obtaining competitively priced D&O insurance (or obtaining D&O insurance at all) for an extended period of time for entities which have been subject to class action proceedings;

[1] John Price, ASIC Commissioner, 'Continuous disclosure by listed companies is one of the key foundations of market integrity', speech to the Governance Institute for publication in the Governance Directors magazine (February, 2014).

- may in the future lead to appropriately skilled and qualified individuals being increasingly reluctant to become directors for fear of personal liability exposure; and
- contributes, directly or indirectly, to an environment of greater risk-aversion in Australia's boardrooms, with a flow-on impact on the way in which investment decisions are made, capital is allocated, and the economy grows

In the US context, which has parallels with the Australian context, a report prepared in 2014 for the US Chamber Institute for Legal Reform, *Economic Consequences: The Real Cost of US Securities Class Action Litigation*, suggests that, rather than benefiting shareholders, private securities class actions significantly harm investors and the economy. The report concludes that ultimately, settlements in these types of cases are relatively minor compared to the overall shareholder wealth destroyed by the lawsuits and result in arbitrary wealth redistribution[2].

While the AICD acknowledges the importance of class actions generally in securing access to justice, we note that no securities class actions have proceeded to final judgment and the boundaries of the law are therefore untested. This makes it difficult to assess the extent to which the current framework is achieving access to justice in practice, and highlights a concern that settlements are being reached pragmatically as a matter of commercial necessity in order to avoid protracted legal proceedings and associated costs. The lack of guidance on how damages should be quantified may contribute to the push towards commercial settlements, while also making it very difficult for companies provisioning for any settlement or award against them.

AICD Recommendation

For the reasons set out above, we consider there is a persuasive case for a review of both the continuous disclosure regime, and the provisions relating to misleading and deceptive conduct, as Proposal 1-1 suggests. The review would, amongst other things, present an opportunity for the government to consider whether there may be more appropriate remedies and enforcement mechanisms available which would achieve the goals of market integrity and investor protection, while addressing the issues associated with the prevalence of class actions. Alternatively, there may be a need for stronger defences to provide better protection for companies and directors who act honestly and diligently.

The AICD considers it essential for the review to evaluate the necessity and effectiveness of s 674 of the Corporations Act, particularly given it is not a feature of the continuous disclosure regime in major comparable jurisdictions, including the UK, Canada and the US. In light of the increasing number of disclosure-based securities class actions against listed entities and directors, who are exposed to liability even in the absence of knowing wrongdoing or misleading conduct, the AICD considers it an opportune time to consider

[2] Prepared for the U.S. Chamber Institute for Legal Reform by M Bajaj, N Caswell, A Goel, S Mazumber and R Surana, *Economic Consequences: The Real Cost of US Securities Class Action Litigation,* February 2014

whether the laws in Australia are appropriately balanced, recognising their fundamental objectives of market integrity and investor protection.

The AICD also strongly recommends that a review should consider the issue of forward looking statements and liability exposure under s 728(2) of the Corporations Act. Unlike Australia, the UK, Canada and the US all provide some measure of protection for directors for forward looking statements. In the UK, s 463 of the Companies Act provides that a director will not be liable to any third party who has placed reliance on statements contained in the narrative parts of an annual report, and a director is only liable to the company for those statements if he/she knew that statement was misleading or was reckless as to whether it was misleading or he/she dishonestly omitted material information.

Similarly, the US and Canada provide companies and directors with a safe harbour exemption where the forward-looking statement contains robust cautionary statements which identify key factors that could cause the actual results to differ materially from those in the forward-looking statement.

The AICD believes there is a strong case for similar protections in Australia.

3. Regulating litigation funders

The AICD has consistently argued that litigation funders should be subject to an appropriate and nationally consistent regulatory regime which goes beyond the need to simply have adequate conflicts of interest arrangements in place, as is presently the case under the *Corporations Regulations 2001* (Cth). Part of this regulatory regime must consist of a robust licensing regime for litigation funders.

For this reason, and for reasons set out in our submission to the Victorian Law Reform Commission Inquiry into Class Action dated 6 October 2017 (enclosed with this submission), the AICD strongly supports Proposal 3-1 and 3-2 in the Discussion Paper. The growing prevalence and activity of Australia's securities class action market underlines the importance of moving away from the current *ad hoc* approach taken to third party funders. The AICD's long-standing preference has been for the introduction of a customised licensing regime included within Chapter 7 of the Corporations Act. The proposed approach taken by the ALRC is, in our view, the preferred approach.

Our response to the specific questions posed by the ALRC are as follows:

Question 3-1: What should be the minimum requirement for obtaining a litigation funding license, in terms of the character?

It is essential that any regulatory regime takes into consideration the significant control and influence that a litigation funder can exercise over the conduct of litigation. Through the contractual arrangements made with lawyers and plaintiffs, litigation funders perform a role which is similar to that of a legal practitioner, including directing proceedings,

recommending certain tactics in litigation, and receiving confidential and privileged client information.

Having said this, we agree that it is not necessary for litigation funders to have the same standards as those placed on the legal profession, given that legal professionals ultimately interface with a court in class actions in any event. Instead, the AICD suggests an approach similar to that taken by the Corporations Act in relation to Australian Financial Services Licence (**AFSL**) holders, with requirements of:

- good fame and character; and
- organisational competency in relation to the legal and financial aspects of litigation funders, but with particularly emphasis on financial competencies.

A special emphasis on financial competencies makes sense, given that legal assistance can be obtained by legal practitioners involved in the class action, and the availability of external counsel to provide legal opinion. In addition, the AICD is aware that funders often brief external counsel to provide opinions on prospects of proposed class actions. For this reason, the AICD suggests that licensing requirements should place a greater emphasis on the financial management skills and experience of the person or board.

Question 3-2: What ongoing financial standards should apply to third-party litigation funders? For example, standards could be set in relation to capital adequacy and adequate buffers for cash flow.

The AICD agrees with the ALRC that prudential regulation of litigation funders by APRA is inappropriate, given the relatively small size of the litigating funding market in Australia and the limited contagion risk to the broader economy.

However, it is essential that any financial standards require a litigation funder to satisfy:

(a) the Base Level Financial Requirements set out in ASIC Regulatory Guide 166;
(b) the requirements imposed on AFSL licensees who are involved in incurring actual contingent liability to a client in the course of providing a financial service;
(c) a liquid capital reserve requirement which is reasonably proportionate to the amount of its investments in litigation; and
(d) an annual auditing and reporting requirement.

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

The AICD supports requiring litigation funders to join the Australian Financial Complaints Authority. This should provide class members with an appropriate platform to resolve complaints and disputes without the need to resort to legal action.

Currently, there is limited visibility of class-member complaints regarding funder arrangements or conduct, despite the assertion that there is a public benefit to their presence in the market. Recourse to the AFCA would partly address this while removing

the need for consumers to pursue complaints through the courts, thereby creating an additional avenue to pursue access to justice.

4. Commission Rates and Legal Fees

The AICD does not support Proposal 5-1. In addition to the well-ventilated concerns relating to conflicts of interest arising from contingency fee arrangements, the AICD is of the view that existing fee mechanisms provide a sufficient degree of flexibility in relation to legal fees to promote access to justice. Legal practitioners are already entitled to include uplift fees in costs agreements, or provide clients with conditional costs agreements. Given the fact that the funding and class actions market is already very active in Australia, the AICD queries whether there is any need for further fee flexibility for legal practitioners. By way of example, there are currently five competing class actions that have been brought against AMP, suggesting that there is no shortage of funders nor lawyers willing to take on such actions.

We have not seen any compelling evidence that there is unmet demand, or limited access to justice, in the current market. Such evidence should be presented before such a fundamental aspect of the lawyer-client relationship is altered.

Should Proposal 5-1 be adopted by the ALRC as its final position, the AICD strongly supports the inclusion of at least the safeguards in Proposal 5-1, and the leave requirement in Proposal 5-2. The AICD also recommends that the solicitor charging on a contingency fee basis be required to provide full security for costs (rather than simply a requirement to advance the costs of disbursements). This is essential to protect defendants in the event that the solicitor's client incurs an adverse costs order arising from the conduct of the litigation, and also so as to prevent opportunistic claims from being brought with little downside risk for the plaintiff. Without this protection, defendants would face a substantial risk of being unable to recover any of its costs from the many individual class members.

In any event, given the concerns outlined above in relation to unintended consequences arising from the current class actions regime, the AICD recommends that no change be made to fee arrangements which could lead to an increase in class action activity at least until the review suggested in Proposal 1-1 has been completed, so as to avoid exacerbating the problems already being faced.

5. Competing Class Actions

Competing class actions, being multiple class actions arising from the same legal dispute, cause costs and delay for both defendants and plaintiff class members. They undermine the economies of scale achieved by class actions, and they create an unfair impression that the company is under "siege" in the public sphere, causing further damage to a company's brand and underlying market value. They also make it more difficult for disputes to be resolved, as there is no incentive to settle one claim while others are still on foot.

For this reason, the AICD supports Proposal 6-1 to introduce a specific Court power to permit only one proceeding to progress, while ordering a permanent stay on other competing proceedings, subject to the overriding discretion to do otherwise in the interests of justice. This is a sensible proposal which would formalise the approach taken to competing class actions in the *GetSwift* litigation, where the Court stayed two class action proceedings and allowed one to continue.[3] The AICD also supports the inclusion of the procedure for dealing with competing class actions in the practice note, given the flexibility this provides.

Question 6-1: Should Part 9.6A of the Corporations 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?

The AICD supports conferring an exclusive jurisdiction on the Federal Court of Australia with respect to matters, commenced as representative proceedings, arising under the Corporations Act and the *Australian Securities and Investments Commission Act 2001* (Cth). The AICD is of the view that if the reforms proposed by the ALRC are adopted, there would be a greatly heightened risk of "forum shopping" at a state level.

In addition, the AICD is concerned that, without the imposition of an exclusive jurisdiction, the cross-vesting legislation in place would not be adequate to protect defendants and plaintiff class members from protracted and expensive disputes arising out of applications to transfer proceedings between various jurisdictions. It would also tend to undermine the ALRC's objective of "front-loading" the case management of class actions to resolve issues relating to competing class actions.

6. Settlement approval and distribution

The AICD supports Proposal 7-1. Any measures which might assist in reducing the potential for unnecessary costs to be incurred in class actions proceedings will ultimately assist all parties in resolving the dispute in a just, quick and cheap way. We anticipate that, in some circumstances, the appointment of a referee to assess costs would create a downward pressure on legal fees, and remove the danger of bias.

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?

While acknowledging the importance of open justice, the AICD is concerned that disclosing aggregate settlement sums, and other information such as legal fees and funder's fees may discourage parties from entering into sensible and commercially acceptable settlements. For this reason, we suggest a careful examination of this issue is undertaken before any recommendations are put forward. It would need to be clear, before any

[3] *Perera v GetSwift Limited* [2018] FCA 732 [3].

change is made, that there is a strong public interest in making such a change, which would justify a departure from the ordinary principles and practice relating to settlements.

7. Next steps

We hope our comments will be of assistance to you. If you would like to discuss any aspect of this submission, please contact Matt McGirr, Policy Adviser, on (02) 8248 8431 or mmcgirr@aicd.com.au.

Yours sincerely,

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