Australian Law Reform Commission
Sydney NSW 2001

By Email Only: class-actions@alrc.gov.au

Inquiry into Class Action Proceedings and Third-Party Litigation Funders ("Inquiry") Submission by Zurich Australia Insurance Limited ("Zurich")

6 August 2018

1. Thank you for the opportunity to provide a submission in response to Discussion Paper 85 dated June 2018.

2. Zurich is the Australian arm of Zurich Insurance Group, a leading multi-line insurer that serves its customers in global and local markets. Zurich insures many of the ASX Top 100 companies.

(a) Zurich recognises and endorses the important role of the continuous disclosure laws in Australia's corporate environment. Zurich also recognises the role of the shareholder class action as a means of providing redress when the obligations of continuous disclosure are not adhered to by a company. However Zurich is concerned that the shareholder class actions landscape is fundamentally different from the regime under contemplation when representative class actions were first introduced.

(b) Zurich welcomes the Inquiry and the opportunity it affords to revisit the representative proceedings regime as it applies to shareholder class actions.

(c) Zurich is currently involved, as either primary or excess insurer, on a significant number of shareholder class actions.[1] As a consequence, Zurich has had an opportunity to identify a number of systemic issues with the shareholder class action regime, which it wishes to raise in order to assist the Inquiry.

3. Zurich's aim is for certain reforms to be made which will:

    (a) provide all stakeholders in shareholder class actions with greater certainty as to both process and the corporation's obligations at law,

    (b) ensure that compensation paid to class members is more closely aligned with their actual loss and prospects of success, and

    (c) increase the prospects of shareholder class actions being resolved at an earlier stage at reduced cost and inconvenience to those involved in the process.

4. We address in these submissions certain of the proposals and questions raised in the Discussion Paper. We do not respond to all of the proposals and questions, only those where we have a specific response.

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[1] Zurich is also involved as either primary or excess insurer in a number of other class actions, for example consumer class actions, but focuses in this submission on the issues raised by shareholder class actions.

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1. Proposal 1-1: a review of the legal and economic impact of continuous disclosure obligations

1.1 Overview of issue

5. Continuous disclosure laws are a necessary feature of Australia's corporations law landscape that ensure an efficient market and the correct value of a corporation's securities. Accordingly, it is not Zurich's submission that those laws should be narrowed in any way.

6. Prior to the decision in *In re HIH Insurance Ltd*,[2] shareholder class actions were primarily brought on the basis of direct reliance upon statements contained in documents or announcements published by corporations. Since the time of that decision, corporations have found themselves the target of litigation based on indirect reliance or market causation. There has been a significant increase in the number of shareholder class actions which are based upon claims that earnings forecasts or earnings guidances published by a corporation either were incorrect at the time of their publication, or became incorrect at some point after their publication. Since class actions brought on this basis are a relatively new feature of the Australian shareholder class action landscape, there is a present uncertainty in the law as to the circumstances in which a corporation is likely to be found to have breached its continuous disclosure obligations, and its obligations to refrain from engaging in misleading and deceptive conduct, in relation to its earnings guidances and earnings forecasts.

7. The increase in shareholder class actions has led to a significant increase in the premiums that several insurers have charged for directors' and officers' (**D&O**) insurance cover since 2017. For example:

   (a) D&O Insurance premiums increased by 200% in the last 12 to 18 months (FY16/17) as the D&O premium pool struggles to cover the number of shareholder class actions filed each year;[3] and

   (b) The Insurance Council of Australia reported that the four shareholder class actions issued in the first quarter of 2017 were likely to drain the entire $280M pool of D&O insurance premium in Australia.[4]

8. At present, a corporation's exposure to direct financial loss as a result of shareholder class actions is limited to the Deductible payable under its D&O policy, any component of loss and damage sought to be recovered in the shareholder class action which might be excluded from cover under the terms and conditions of the relevant policy, and any subsequent increase in future D&O insurance premiums payable by that corporation as a result of the class action in question.

9. If comprehensive D&O insurance cover becomes unaffordable to the majority of publicly listed corporations in Australia, then the corporation itself will be exposed to the direct financial losses flowing from the uninsured components of shareholder class actions,

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[2] [2016] NSWSC 482

[3] King Wood and Mallesons, The Review: Class Actions in Australia 2016/2017, p. 2

[4] Insurance Council of Australia, *Access to Justice - Litigation funding and group proceedings*, 30 October 2017

with the result that the corporation's losses will ultimately be visited upon its shareholders.

1.2 Potential solutions

10. Zurich submits that some certainty or guidance as to the continuous disclosure obligations in respect of the publication of forward-looking statements would be timely. Zurich submits that some certainty could possibly be created by implementing one or both of the following measures:

    (a) Enactment of a reasonable steps defence similar to section 1022B of the Corporations Act 2001 (Cth) (**Corporations Act**) in respect of product disclosure statements. The relevant provision could set out the kinds of minimum steps that should be taken prior to a corporation publishing a forward-looking statement, and the minimum steps that ought to be taken after the publication of the statement in question, with a view to ensuring that subsequent events do not later render the forward-looking statement unreliable.

    (b) Publication by ASIC of a Regulatory Guide which supplements RG 170[5] (which deals with the reasonableness of the basis for forecasts and forward-looking statements) by clarifying the kinds of minimum steps required of listed corporations before and after publishing forward-looking statements. ASIC could also publish a best practice guide in this regard similar to RG 62[6].

2. Proposals 3.1-3.2 - regulation of litigation funders

11. Zurich has noted the increase of companies in the litigation funding landscape, particularly those based in foreign jurisdictions. Zurich welcomes and endorses the proposal to regulate litigation funders but, save as regards conflicts of interest (discussed below), does not make any specific comment.

3. Proposals 4.1, 4-3 and 4.6 - conflicts of interest

3.1 Overview of issue

12. Shareholder class actions are generally brought on behalf of investors who acquired shares in the defendant corporation during an alleged Relevant Period. Whilst some of these Relevant Periods can be relatively small (say four months in duration), others can be anywhere between 6 and 15 months, or longer, in duration. Of the shareholder class actions filed since 2017, six class actions have a Relevant Period of between six and 12 months, and a further five have a relevant period that extends for a period greater than 12 months.

13. A significant number of shareholder class actions tend to proceed on the basis that:

    (a) A corporation published a forward-looking statement without a reasonable basis for making that statement; and/or

[5] RG 170 Prospective Financial Information.

[6] RG 62 Better Disclosure for Investors.

(b) That corporation, after publishing the forward-looking statement referred to above, later became aware of information which:

(i) was not generally known or available in the market;

(ii) rendered the earlier forward-looking statement unreliable; and

(iii) the corporation failed to make prompt disclosure of that information, which caused it to breach section 674 of the Corporations Act and rendered the forward-looking statements misleading or deceptive until the relevant information was disclosed to the market.

14. In practice, it is not usually one, but several pieces of information which, when taken together, arguably render the earlier forward-looking statements unreliable. Indeed, the event studies prepared by the expert witnesses retained in the proceedings often tend to quantify the class's loss and damage on a sliding scale; often, those investors who acquired their shares at an earlier point in the Relevant Period are said to have lower prospects of success than those who acquired their shares at a later point in the Relevant Period. This is a logical outcome since, the more time that passes, the more information and data a corporation tends to acquire. In other words, as more information is acquired which potentially renders an earlier forward-looking statement unreliable, the greater the risk that information will be material to the price of the corporation's shares.

15. However, shareholder class actions do not proceed on the basis of subclasses. Shareholders receive an amount of any settlement sum which is based on a *pari passu* distribution of the settlement sum according to the number of shares owned by each shareholder. The settlement is not structured in a way that reflects the likely prospects of success of each class member, depending upon the point in time during the Relevant Period at which they acquired their shares in the subject corporation. In practice, this means that shareholders who acquired their shares at an earlier point in the Relevant Period will receive an amount of compensation which overstates their prospects of success (based on the expert evidence), whilst those shareholders who purchased their shares at a later point in the Relevant Period will receive an amount of compensation which potentially understates their prospects of success.

16. Plaintiff lawyers and funders are resistant to attempts to negotiate settlements that recognise the differing merits of different subclasses of shareholders, presumably on that basis that doing so would place them in a position of conflict vis a vis two or more subclasses of the overall class. This is a significant impediment to a fair settlement process, a key aim of which is ensuring that the amount of compensation that individual shareholders receive appropriately reflects the merits of their claim.

3.2 Potential solutions

17. Zurich endorses Proposal 4-3 generally.

18. Zurich also endorses Proposal 4.6 and recommends that the Practice Note be amended so as to require plaintiff lawyers to advise their class, at an early stage, of potential conflicts of interest arising as a result of differing prospects of success between the members of the class. Further, Zurich raises for consideration:

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(a) Requiring plaintiff law firms to, if necessary, disclose any developing conflicts of interest that emerge following the provision to existing or potential class members.

(b) The issue of conflicts of interest should be addressed in all opt out notices to potential class members.

19. In the recent decision in *GetSwift*,[7] Justice Lee, ordered, amongst other things, that an independent referee be appointed to review the plaintiff class' costs, and that the court appoint its own independent expert economist on the matters of loss, causation and quantum. Zurich supports creative approaches towards managing what is a relatively new and expensive area of litigation.

20. Zurich raises for consideration granting courts the power to appoint independent counsel to participate in the mediation process on the following basis:

(a) Independent counsel will be provided with the reports prepared by the parties' experts and/or the court's expert (if any).

(b) The parties will negotiate a settlement between themselves.

(c) In the event that the parties are able to agree an in-principle settlement which involves the class being split into subclasses according to when the shares in issue were purchased, independent counsel will provide an opinion as to whether the proposed subclasses and amounts of compensation are prima facie reasonable with reference to the independent expert material.

(d) Counsel for the plaintiff will provide their own opinion as to the reasonableness of the overall settlement sum with reference to the class' overall prospects of success on the questions of liability and causation.

21. The above approach is intended to remove the potential conflict of interest issue, whilst also ensuring that the amount of compensation paid to each shareholder provides as realistic a reflection as possible of that shareholder's prospects of success.

22. Canada and the United States have recognised the possibility of splitting a class into subclasses where a conflict of interest arises between those subclasses, and appointing separate sets of lawyers to act for each subclasses. Whilst such a solution would undoubtedly be effective, Zurich does not support such a proposal as it would create additional cost and delay for both the shareholder class and the defendant.

4. Proposals 6.1 and 6.2 - competing class actions

4.1 Overview of issue

23. Competing class actions appear to be on the rise. The impact on court resources, the cost of legal proceedings (with consequent erosion of the "pot" of money available to the shareholder class), and the risk of disparate findings are well recognised.

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

4.2 Potential solutions

24. Zurich endorses Proposal 6-1, and specifically that all class actions should be filed as open class actions. Closed class actions do not promote finality in that those who do not enter into funding agreements with the relevant litigation funder are free to pursue their own claim in relation to the same subject matter. As a result, closed class actions increase the risk of a respondent corporation facing either competing or consecutive class actions in respect of the same/substantially the same conduct. Further, open class actions provide greater scope for courts to regulate the terms of funding between the litigation funder and shareholders. For all of those reasons, Zurich supports the proposed interlocutory steps set out at paragraph 6.46 of the Discussion Paper.

25. With respect to the defined time for all other competing class actions to be filed, Zurich considers that a period of four months would be sufficient. Zurich recommends that procedural steps in all competing class actions be suspended until the Court determines which class action will proceed.

26. With respect to the criteria to be adopted when resolving the issue of how to manage competing class actions, Zurich endorses the adoption of criteria along the lines of those applied by his Honour Justice Lee in *GetSwift*. Zurich notes that, whilst there is some overlap between the criteria applied by Lee J in *Getswift* and the 16-point approach adopted by Canadian courts, the criteria applied by Lee J has a stronger focus upon managing cost, expense and delay of the class action, whilst the Canadian criteria has a greater focus on the merits of the causes of action underlying each proceeding. Zurich supports the adoption of criteria concerning case theory, scope of causes of action and selection of defendants to the extent that the Court considers that it is able to make assessments of those matters at a relatively early stage of the proceeding. Zurich also supports the adoption of a criteria concerning prospects of success and in that regard refers to its submissions below concerning certification of class actions.

27. Zurich endorses Proposal 6-2 and raises for consideration amendment of the Practice Note to provide that one of the issues to be addressed at the first case management conference is the making of common fund orders and the time for the opt-out period to end. This latter issue is of particular importance to Zurich's submission in relation to the timing of provision of Particulars of the class (discussed below).

28. Finally, Zurich also agrees with the ALRC's proposal that class closure occur prior to mediation and not be reopened again after mediation. This proposal does not increase the risk of a multiplicity of proceedings against a corporation based on the same subject matter if the proposal that all class actions proceed as open class actions, is adopted.

5. Proposal 8-1 - Regulatory redress

29. The Inquiry has raised for consideration whether there should be a regulatory redress scheme for shareholder class actions, and has noted the scheme in the United Kingdom which provides such redress, via the regulator, for consumer claims.

30. This would appear to shift the onus to bring claims primarily to ASIC. We query how the scheme would deal with shareholder claims given usual need for expert evidence on the state of the market, causation not being settled law and whether coverage is triggered for insureds when involved in a scheme as opposed to a “claim” defined in the insurance policy?

6. Other issues: impediments to timely resolution

6.1 Overview of issue

31. Whilst Zurich does not accept that all shareholder class actions will always settle, it is correct that the majority have settled and will settle. It is in all parties' interests for that settlement to take place at an appropriate time and that the available "pot" of funds with which to settle are not unnecessarily eroded by defence costs and plaintiff's costs. In Zurich's experience, costs incurred by the plaintiffs by the time of mediation range on average between $7M to $12M, and by the defendants between $4M to $10M.

32. An important step on the road to resolution is understanding the likely potential quantum of the claim, which in turn depends on the numbers of shareholders (by value) likely to participate.

33. Until class closure occurs, the plaintiff cannot provide details of the number of shares that have been signed-up to the plaintiff class which, in turn, means that the defendant is unsure as to maximum potential value of the class' claim. This prevents the defendant (and its insurers) from considering whether to make any early settlement offers.

34. In closed class actions, plaintiff lawyers are incentivised to delay class closure for as long as possible so as to continue building their book.

35. In open class actions, it is common for class closure only to occur shortly before hearing.

36. Zurich notes that, in *Melbourne City Investments Pty Ltd v Treasury Wine Estates Limited,*[8] the Full Court of the Federal Court of Australia held that the facilitation of settlement was a good reason for making early class closure orders so as to allow both sides to have a better understanding of the total quantum of class members' claims and to assist in achieving finality.

6.2 Potential solutions

37. If closed class actions continue, then Zurich raises for consideration amendment of the Practice Note to provide that class closure will <u>occur 60 days after the close of pleadings</u> (on the basis that pleadings in class actions will not close until after any competition between class actions has been resolved).

38. With respect to open class actions, Zurich raises for consideration class closure occur at a reasonably early stage in the life of the proceeding, say shortly before any mediation or other settlement process - <u>90 days after the close of pleadings</u> (on the basis that pleadings in class actions will not close until after any competition between class actions has been resolved).

39. In both cases, Zurich raises for consideration amendment of the Practice Note to require the plaintiff's lawyer is required to deliver to the lawyers for the defendant particulars of the class within 30 days of class closure occurring. This would provide defendants, their lawyers and insurers with a reasonable opportunity to consider whether to make any early settlement offers to the plaintiff class.

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[8] [2017] FCAFC 98

7. Other issues - Certification of class actions

40. Zurich appreciates that the Inquiry did not make any proposals in respect of certification. However, Zurich considers that the introduction of a limited certification process would compel lawyers to apply more discipline in framing the terms of their class action at an earlier stage. In turn, it would ensure that class actions which lack a proper basis are screened out and do not waste the time and resources of the defendant and its insurers.

41. Zurich recognises that the Victorian Law Reform Commission recommended against the introduction of a certification requirement into Victorian class actions[9] in circumstances where it considered that:

    (a) the Victorian class action regime has not been used often; and

    (b) the introduction of a certification process akin to those found in the Canadian and US jurisdictions carries the risk of increasing cost, complexity and delay in the conduct of the litigation.

42. Zurich considers that the aim of any certification process should be ensuring that the class actions which come before the Court have a reasonable basis, and that the litigation be conducted in a manner that promotes as early and cost-effective a resolution as possible. The certification process would not need to descend into points of pleading or technical arguments of law. Accordingly, Zurich agrees that an elaborate certification process identical to those found in certain jurisdictions in Canada and in the United States is undesirable. For example, the Ontario certification process generally requires the filing of extensive affidavit evidence, expert reports and written materials, and often takes up to a year before the motion for certification is heard, with the greatest cost being incurred during the hearing to determine which issues are common issues for the purposes of the class action. Such a mechanism is unlikely to reduce the costs of resolving class actions and is likely to only prolong the resolution of the matters in dispute.

43. Conversely, in Quebec, the process is far less onerous. In that jurisdiction, the primary role of an authorisation motion is to ensure that the plaintiff class has an arguable case (rather than engaging in a merits review as occurs in Ontario), and the judge's role is to screen out frivolous cases. Unlike the position in Ontario, the defendant does not have a right to make submissions to the Court and must apply to the Court for permission to do so.

44. Whilst the Victorian class action regime may be under-utilised, the Federal Court regime is utilised far more frequently, with 14 shareholder class actions filed in the Federal Court since 1 July 2016. Zurich is aware of a small number of filed/threatened class actions which have been commenced on the basis of a misunderstanding of key facts and figures contained in the defendant's financial reports and/or ASX Announcements. The result has been to require the prospective/defendant to incur substantial cost in edifying the plaintiff class' representatives as to why their claim cannot succeed.

45. In all the circumstances, Zurich submits that a form of certification should be considered, albeit one which does not increase the costs and delays of class action proceedings.

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[9] Victorian Law Reform Commission, *Litigation Funding and Group Proceedings: Report*, 19 June 2018

7.1 Potential solutions

46. In light of Proposal 6-2 and the criteria proposed to be applied in identifying competing class actions, Zurich submits that an appropriate approach could be that taken by the courts in Quebec. However, it appears that criteria will only be applied where there are competing class actions. Zurich submits that even non-competing class actions ought to be required to demonstrate the following:

    (a) The class action has a prima facie reasonable basis.

    (b) The experience or competence of the legal practitioners.

    (c) Whether there has been any operative delay or dilatoriness of the plaintiff.

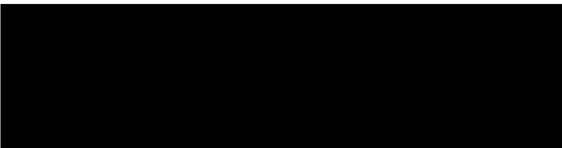
    (d) What proposals have been made in relation to the appointment of experts that are likely to reduce costs.

    (e) What proposals have been made for processes to control costs during the course of proceedings.

47. Zurich also submits that the defendant ought to be provided with a limited right of reply to the plaintiff's submission as to its ability to satisfy the above criteria.

Zurich thanks again the ALRC for the opportunity to provide these submissions, and would be pleased to provide any further assistance or comment that might assist.

Yours faithfully



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