Email 6 August 2018

The Hon. Justice S C Derrington
President
Australian Law Reform Commission
GPO Box 3708
Sydney NSW 2001

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Dear President

Inquiry into Class Action Proceedings and Third-Party Litigation Funders

Law Firms Australia ('LFA') appreciates the opportunity to provide a submission on the discussion paper ('the Discussion Paper') to the Inquiry into Class Action Proceedings and Third-Party Litigation Funders ('the Inquiry'). LFA also appreciates that a short extension of time was granted to make the submission.

LFA represents Australia's leading multi-jurisdictional law firms, being Allens, Ashurst, Clayton Utz, Corrs Chambers Westgarth, DLA Piper Australia, Herbert Smith Freehills, King & Wood Mallesons, MinterEllison and Norton Rose Fulbright Australia. LFA is also a constituent body of the Law Council of Australia ('LCA'), the peak representative organisation of the Australian legal profession.

LFA member firms consider the issues raised by the Inquiry to be very important. As such, some LFA members will make additional, independent, submissions to the Inquiry. The purpose of this submission is to address the following areas of common interest: continuous disclosure and shareholder class actions; the regulation of litigation funders; contingency fees; competing class actions; settlement confidentiality, and; collective redress.

1. Continuous disclosure and shareholder class actions

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.

1.1 LFA strongly supports Proposal 1-1, as do many clients of its member firms.

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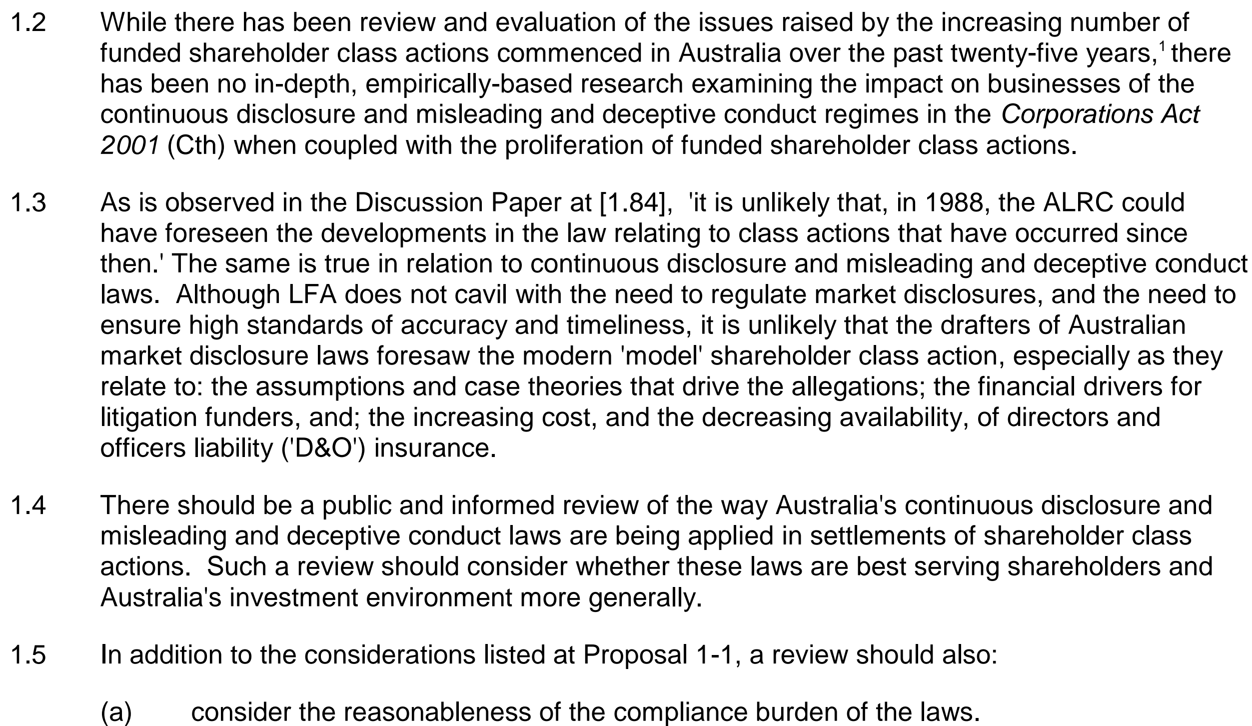

1.2 While there has been review and evaluation of the issues raised by the increasing number of funded shareholder class actions commenced in Australia over the past twenty-five years,[1] there has been no in-depth, empirically-based research examining the impact on businesses of the continuous disclosure and misleading and deceptive conduct regimes in the *Corporations Act 2001* (Cth) when coupled with the proliferation of funded shareholder class actions.

1.3 As is observed in the Discussion Paper at [1.84], 'it is unlikely that, in 1988, the ALRC could have foreseen the developments in the law relating to class actions that have occurred since then.' The same is true in relation to continuous disclosure and misleading and deceptive conduct laws. Although LFA does not cavil with the need to regulate market disclosures, and the need to ensure high standards of accuracy and timeliness, it is unlikely that the drafters of Australian market disclosure laws foresaw the modern 'model' shareholder class action, especially as they relate to: the assumptions and case theories that drive the allegations; the financial drivers for litigation funders, and; the increasing cost, and the decreasing availability, of directors and officers liability ('D&O') insurance.

1.4 There should be a public and informed review of the way Australia's continuous disclosure and misleading and deceptive conduct laws are being applied in settlements of shareholder class actions. Such a review should consider whether these laws are best serving shareholders and Australia's investment environment more generally.

1.5 In addition to the considerations listed at Proposal 1-1, a review should also:

(a) consider the reasonableness of the compliance burden of the laws.

This is in the context of the risk that a shareholder class action might be commenced as a result of boards 'getting it wrong'. The risk of being targeted in a shareholder class action is an increasingly significant concern for boards and executives of listed entities when determining whether there is a continuous disclosure requirement concerning a particular piece of information. The pressure on a board is amplified by the price of getting the relevant assessments wrong, namely, the risk that a class action will be commenced against the company as a result of a disclosure of negative information. The damages resulting from a shareholder class action will usually dwarf any penalties or fines that are applied by the Australian Securities and Investment Commission.

(b) consider the approach of other jurisdictions to this issue.

For instance, the disclosure regime in the United States is based on a quarterly reporting system.[2] While the listing rules in the United States impose continuous disclosure requirements on publicly listed companies, the statutory framework does not require continuous disclosure.[3] Further, the listing rules do not give private enforcement rights to investors in relation to disclosure obligations.[4]

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[1] See e.g. Vince Morabito, 'The First Twenty-Five Years of Class Actions in Australia: An Empirical Study of Australia's Class Action Regimes, Fifth Report' (July 2017).

[2] Brown, Stephen and Shekhar, Chander, 'Continuous Disclosure in Australia and the United States: A Comparative Analysis' (August 2016).

[3] Ibid.

[4] Ibid.

the propensity for corporate entities to be the target of funded shareholder class actions in Australia

1.6 Whilst it is appropriate for boards of listed entities to consider their market disclosure obligations on an ongoing basis, the guidance available to boards in identifying whether a matter requires disclosure means that directors and executives must weigh difficult and, in many cases, subjective considerations. This includes the certainty or completeness of the relevant information, and the likely reaction of investors. Directors and executives do not have the benefit of hindsight – that is: knowledge of the actual impact on the share price, and insights from analysis and review of documents discovered in court proceedings over several months by reference to case theories that have in turn been developed over the course of several months.

1.7 ASX Listing Rules Guidance Note 8 acknowledges that:

> …the test for determining materiality of information in section 677 can give rise to some difficulty in practice for entities in assessing whether or not they have an obligation to disclose information under Listing Rule 3.1. They are effectively required to predict how investors will react to particular information when it is disclosed.

1.8 In the experience of LFA member firms, the boards of their ASX-listed clients take their continuous disclosure obligations extremely seriously. Challenges often arise before the information percolates to the boards; in most organisations, the information that leads to a material decision comes from a wide range of places, levels and personnel. Certain pieces of information, for example, revenue streams, are likely to be composed of multiple inputs each requiring investigation and verification. This creates huge pressure on the boards of listed entities to understand, clarify and disseminate what might be complex information as quickly as possible.

1.9 The decision as to whether to disclose must be made 'promptly and without delay' in circumstances where directors will need to have sufficient information at appropriate levels, and also need time to make an informed decision about a piece of information. Often this process will require the making of further enquiries within the company and seeking independent advice if necessary. Once the board is advised of the relevant information, directors must consider the timeliness of disclosure, including whether disclosure might be premature or whether it might be too late.

1.10 Any significant share price drop following an announcement will be closely examined by a class action 'promoter' to consider whether the drop provides sufficient grounds to commence an action. As summarised at [1.77]-[1.78] of the Discussion Paper, 'the standard approach' to shareholder actions is to:

(a) identify a significant drop in the value of securities, and

(b) undertake an analysis to determine 'whether it is likely that the relevant drop had been occasioned by the late revelation of material information.'

1.11 Underpinning that analysis is the assumption (the robustness of which applicants and respondents routinely dispute) that if the market has reacted negatively to a piece of information, that information may be at least prima facie indicative of a prior omission / non-disclosure by the respondent company, in breach of the company's continuous disclosure obligations.[5] The strict liability fault requirements relating to continuous disclosure and misleading or deceptive conduct

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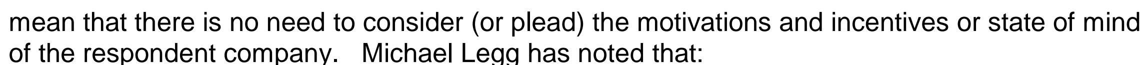
[5] See, e.g. 'Structural and Forensic Developments in Securities Litigation', transcript of the speech given by the Honourable Justice Jonathan Beach, delivered at the International Commercial Law Conference (Inner Temple, Inns of Court, London), June 2016.



mean that there is no need to consider (or plead) the motivations and incentives or state of mind of the respondent company. Michael Legg has noted that:

> A shareholder, individual or institution, now has better prospects of success in litigation due to the broad statutory causes of action based upon misleading or deceptive conduct and contravention of continuous disclosure requirements. The statutory provisions focus on consequences so that there is no need to prove a particular state of mind as in fraud or establish a specified degree of fault as in negligence.[6]

1.12 The LCA has previously recommended that the ASX consider amending Listing Rule 3.1 to require disclosure 'as soon as practicable' rather than 'immediately'.[7] Such an approach would better allow for the fact that the processes in place for releasing an announcement will generally require a proper assessment of the information available, the making of appropriate judgments, and both internal and external consultation. While the ASX notes that it will recognise the circumstances which may cause a delay, such recognition is not always afforded to a corporate respondent by applicants in class actions.

The value of the investments of shareholders of the corporate entity at the time when that entity is the target of the class action

1.13 The economic impact of class actions on corporate Australia should be canvassed as part of any review. The Discussion Paper notes at [1.73]:

> …there is growing evidence of unintended adverse consequences caused by the existing framework of the Australian class action regime, coupled with the peculiar characteristics of the Australian statutory provisions concerning continuous disclosure obligations (as compared with some other cognate common law jurisdictions) and those relating to misleading and deceptive conduct. Those consequences include the impact on the value of the investments of those shareholders (including the investments of the class members themselves) of the company at the time the company is the subject of the class action, and the impact on the availability of directors and officers insurance (D&O insurance) within the Australian market.'

1.14 Based on the observations of LFA's member firms and their clients, there are several potential negative economic impacts that should be considered:

(a) Payment or contribution to payment of settlements.

It is not the case that every listed ASX entity has sufficient insurance cover to respond to the damages claimed in a shareholder class action. LFA member firms are aware of settlements in which the respondent company has been required to pay a significant proportion of the settlement amount due to insufficient insurance funds (either because coverage for shareholder class action claims was too low, or the policy had been eroded to an extent that the remaining insurance funds were insufficient).

(b) Impact on the value of existing shareholdings.

Leaving aside a shareholder class action's less tangible impact on the operations of a respondent company in the form of management distraction and/or adverse reputational issues, any direct payment by respondent companies of some or all of a settlement sum may affect the value of the investments of shareholders who hold a shareholding in the

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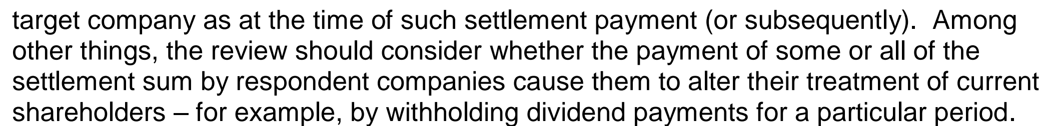
[6] Michael Legg, 'Shareholder class actions in Australia—the perfect storm?' (2008) 31 UNSW Law Journal 669, 706.

[7] Letter from LCA to ASX Limited entitled 'Continuous disclosure' (16 December 2011). Available at <http://www.lca.lawcouncil.asn.au/lawcouncil/images/LCA-PDF/docs-2400-2499/2495%20Continuous%20Disclosure.pdf>.



target company as at the time of such settlement payment (or subsequently). Among other things, the review should consider whether the payment of some or all of the settlement sum by respondent companies cause them to alter their treatment of current shareholders – for example, by withholding dividend payments for a particular period.

There is anecdotal evidence that the announcement of class actions can create downward pressure on the share price of the target company.[8] Any review should explore the impact of the announcement / filing of class actions, on the share price of the corporate respondent. Any negative impact on the share price will affect shareholder investment value.

(c) Inability to access equity markets.

The spectre of a shareholder class action commenced as a result of a reduction in share price following negative market announcements means that there may be categories of corporate entities that are simply 'unlistable'. Such entities would be confined to seeking funding from debt markets, with attendant sub-optimal financing costs. For example, an entity with particularly 'lumpy' or irregular-large-project based income is at risk of undermining guidance given to the market several months earlier if, say, a particular project has a costs blow-out too close to the end of the financial year to be able to salvage any negative impact upon the overall year's results. Where that entity is well-covered by sell-side analysts, it is no answer simply to assert that the entity shouldn't therefore give guidance, and one might query whether entities should be discouraged from giving guidance in any event.

The availability and cost of directors and officers liability cover within the Australian market

1.15 While insurers are perhaps best placed to address the availability and cost of D&O insurance, several clients of LFA members have reported increases in the price of D&O insurance (particularly primary and first excess layers) and/or a decrease in the availability of such cover.[9]

1.16 The Discussion Paper notes at [1.74]:

> The ALRC has heard there has been chronic under-pricing of D&O business by insurers since at least 2011 and that the indications are that the current D&O market premium pool is thoroughly inadequate to meet the current and projected levels of insured securities class action losses. The cost of D&O insurance has increased more than 200% in the last 12 to18 months. At least one significant insurer has recently left the Australian D&O market and there is some (anecdotal at this stage) evidence that the hardening of the market environment for D&O insurance is leading some Australian companies to contemplate relocation offshore where conditions are more favourable.
>
> [Footnotes omitted]

1.17 The increased cost of obtaining and maintaining D&O insurance ultimately inhibits shareholder returns. As Side C cover becomes more scarce, directors and officers are more likely to be targeted as respondents in class actions in order to access Side A or B cover. In turn, high-quality director candidates are likely to accept directorships of listed companies. The potential for, and desirability of, such an outcome should be considered in the proposed review.

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[8] See, e.g. 'S*quire Patton Boggs' $300m claim 'misleading' says GetSwift*', Australian Financial Review (18 July 2018).

[9] See e.g. Show me the money! The impact of securities class actions on the Australian D&O Liability insurance market – XL Catlin/ Wotton + Kearney – September 2017.

2. Regulation of litigation funders

2.1 Having regard to funders' involvement in substantial flows of capital in the economy, the Court has historically considered funded class actions to satisfy the definition of 'managed investment schemes' and 'financial products'.[10] As a result, litigation funders were required to hold, and be subject to the conditions of, an Australian Financial Services Licence ('AFSL').[11]

2.2 However, the *Corporations Regulations 2001 (Cth)* ('the Corporations Regulations') was amended in 2013 to exclude funded class actions from this licensing requirement. Consequently, litigation funding in Australia is only currently subject to minimal regulation. While funders are obliged to manage conflicts of interest,[12] this requirement is a comparatively low regulatory standard.

2.3 LFA acknowledges the importance of litigation funders in class actions, including their role in ensuring that certain claims are capable of being instituted.[13] The increasing prominence of funders in the Australian class actions market has been significant; 63% of claims brought by litigation funders since December 2001 have been in the past five years.[14]

2.4 However, LFA also notes the substantial financial incentive for funders to participate in class actions given their claim to significant proportions of Court-awarded damages or settlements. It has been reported that funders have benefited from access to at least $3.5 billion in Court-approved class action settlements.[15] This financial incentive has been recognised by the Court, most recently in *Perera v GetSwift Limited* [2018] FCA 732 at [24], where Lee J referred to data evidencing the growth of litigation funders in the Australian class actions market.

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.

2.5 LFA agrees with the principle underpinning Proposal 3-1 that litigation funders should be subject to a licensing regime. LFA submits that the litigation funders should again be subject to the AFSL regime as it would be an effective means by which to regulate and review the practices of litigation funders, in accordance with fixed and transparent licence conditions.

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[10] *Brookfield Multiplex Ltd v International Litigation Partners Pte Ltd* (2009) 180 FCR 11; *International Litigation Partners Pte Ltd v Chameleon Mining NL* (2011) 276 ALR 138.

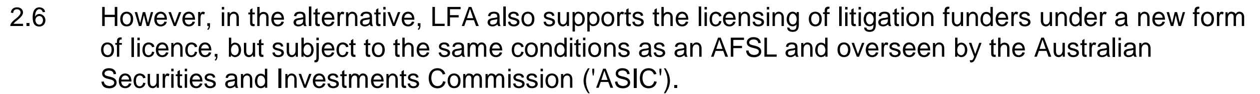
[11] Guy Narburgh and Sally-Anne Ivimey, "Chapter 17 – Side by Side (A, B and C): Securities Class Actions and D&O Insurance", in Damian Grave and Helen Mould (eds) *25 Years of Class Actions in Australia* (The Ross Parsons Centre of Commercial Corporate and Taxation Law, Publication 19), 371, 378.

[12] Corporations Regulations, r 7.6.01AB.

[13] *Newstart 123 Pty Ltd v Billabong International Ltd* [2016] FCA 1194, [51]; *P Dawson Nominees Pty Ltd v Multiplex Ltd* [2007] FCA 1044, [34].

[14] Morabito, above n 1, 34.

[15] The Honourable Justice Bernard Murphy and Vince Morabito, "The First 25 years: Has the Class Action Regime hit the Mark on Access to Justice?' in Damian Grave and Helen Mould (eds) *25 Years of Class Actions in Australia* (The Ross Parsons Centre of Commercial Corporate and Taxation Law, Publication 19), 13, 22.



2.6 However, in the alternative, LFA also supports the licensing of litigation funders under a new form of licence, but subject to the same conditions as an AFSL and overseen by the Australian Securities and Investments Commission ('ASIC').

2.7 The licensing regime for litigation funders should contain the following features:

(a) prudential oversight

(b) a duty of good faith,

(c) no exemption of foreign litigation funders, and

(d) breach notification obligations.

2.8 Each feature is explained below.

Prudential oversight

2.9 Prudential regulation of litigation funders in Australia is necessary due to the uncertain financial position of some funders and the increased involvement by foreign litigation funders in the Australian market.[16] LFA supports the Inquiry's proposal that in order for funders to obtain an AFSL, they would be required to have sufficient financial resources in Australia to conduct their business.[17]

2.10 It is noted that Proposal 3-2(d), which would require a funder to have 'sufficient resources (including financial, technological and human resources)' does not explicitly require the funders' resources to be held in Australia. It is important that a sufficient quantity of funders' resources or capital be required to be based in Australia. This would protect representative plaintiffs, plaintiff lawyers, and defendants from exposure to funders that cannot meet their financial obligations.

2.11 LFA also considers that the Australian Prudential Regulation Authority's capital adequacy requirements should apply to litigation funders[18]. To that end, the applicable prudential requirements should include those that already exist under the AFSL regime in addition to the following further obligations:

(a) satisfy the 'Base Level Financial Requirements' set out in ASIC Regulatory Guide 166,

(b) comply with the minimum financial requirements that apply to specific classes of AFSL holders,[19]

(c) satisfy ASIC that it has sufficient assets to cover the potential liabilities associated with an unsuccessful case, and

(d) maintain liquid capital reserves equal to at least twice the amount of its investments in litigation.

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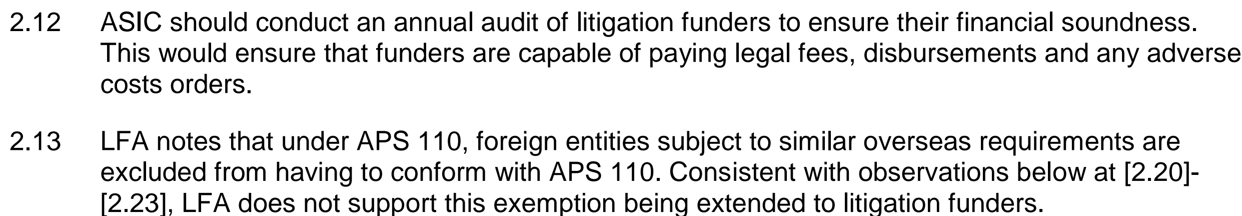
[16] Discussion Paper, [3.61].

[17] Discussion Paper, [3.43], [3.49].

[18] Prudent Standard APS 110 Capital Adequacy ('APS 110').

[19] For example, a litigation funder could be subject to adjusted surplus liquid fund and liquid fund requirements in circumstances where the arrangement under which it conducts business means it is obliged as principal to claimants for an amount in excess of $1,000,000, or where the litigation funder otherwise holds property on trust for the claimants in the sum of $100,000 or more.



2.12 ASIC should conduct an annual audit of litigation funders to ensure their financial soundness. This would ensure that funders are capable of paying legal fees, disbursements and any adverse costs orders.

2.13 LFA notes that under APS 110, foreign entities subject to similar overseas requirements are excluded from having to conform with APS 110. Consistent with observations below at [2.20]-[2.23], LFA does not support this exemption being extended to litigation funders.

Duty of good faith

2.14 Defendants often rely on insurance in responding to class actions, most commonly Side C Insurance (indemnifying a corporation for its liabilities), and after the event insurance. Insurers owe a duty of good faith to the insured; the providers of such products are subject to significant obligations to have regard for, and act in, the interests of policyholders, and the provision of products is carefully monitored by regulatory bodies.

2.15 The role performed by litigation funders for plaintiffs in class actions is analogous to that of insurers for the defendants in a class action, in that a litigation funder bears the costs of running the matter and possibly also the cost of any adverse costs order.[20] However, unlike litigation funders, insurers do not take a proportion of the ultimate settlement sum in the form of profit.

2.16 Given the similar roles of litigation funders and insurers, LFA submits that funders should be required to owe a duty of good faith to class members. This is particularly so given funders' significant financial interest in the outcome of class action matters. Such a duty could be made a condition of a funder's AFSL.

2.17 The introduction of a duty of good faith would establish a higher standard than the current obligation to ‘manage conflicts of interest’ between funders and representative plaintiffs. Under the current duty of good faith on insurers, which includes a duty to act with ‘due regard’ to the insured’s interests,[21] the market (particularly for vulnerable and less sophisticated clients) is able to be confident that insurers are required to satisfy a common objective standard of fairness and honesty.

2.18 Alternatively, the duty could be framed as a 'best interests' duty whereby litigation funders would be required:

(a) to act in the best interest of the claimants, and

(b) to prioritise the interests of the claimants over their own interests or those of a related party.

2.19 Such a 'best interests' duty would be more akin to the obligations on financial advisers.[22]

No exemption of foreign funders

2.20 The Discussion Paper notes at [3.62] that:

> *The existing AFSL regime allows companies and entities that are prudentially regulated overseas to apply for exemption from the financial regulatory requirements in Australia and*

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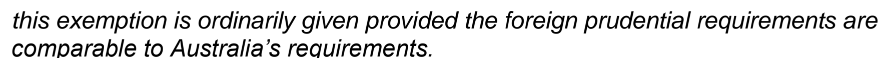
[20] Narburgh and Ivimey, above n 11, 376-377.

[21] *Re Zurich Australian Insurance Ltd* [1998] QSC 209.

[22] *Corporations Act 2001* (Cth), ss 961B, 961J.



this exemption is ordinarily given provided the foreign prudential requirements are comparable to Australia's requirements.

[Footnotes omitted]

2.21 The Inquiry then proposes that a comparable exemption should apply to the litigation funding licence.

2.22 Although LFA recognises the importance of encouraging the participation of foreign capital in the Australian market, it disagrees with the Inquiry's proposal for two broad reasons. First, there is significant ambiguity about the meaning of 'comparable' in the context of litigation funding. Secondly, it will be very difficult for any Australian licensing body to adequately assess whether the regulatory framework for litigation funding in a particular jurisdiction is suitably 'comparable' to Australia. This will particularly be so during the first few years of the proposed framework operating in Australia.

2.23 Accordingly, LFA submits that all funders wishing to participate in the Australian class actions market be required to obtain an Australia licence. This would ensure regulatory consistency, both in establishing a common minimum standard for funders to meet, and in subjecting funders to the same regulatory powers and oversight. Foreign litigation funders should be required, as a licence condition, to expressly:

(a) agree that Australian law governs the funding contract, and

(b) irrevocably submit to the jurisdiction of the relevant Australian court.

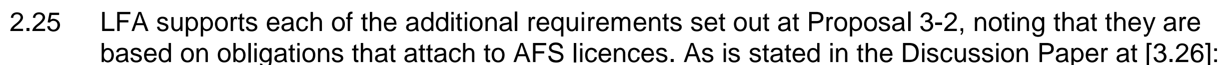
Breach notification obligations

2.24 The consistent enforcement of licensing regimes is often difficult and costly. A litigation funder's licence should include an obligation to notify breaches of licence obligations, similar to a corporation's continuous disclosure obligations, to the regulator. This would assist in ensuring the effective enforcement of the proposed licensing regime. Non-disclosure penalties would promote a positive culture of compliance amongst litigation funders.

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.



2.25 LFA supports each of the additional requirements set out at Proposal 3-2, noting that they are based on obligations that attach to AFS licences. As is stated in the Discussion Paper at [3.26]:

> *…the litigation funding market is broadly analogous with insurance arrangements and managed investment schemes in terms of the pooling of claims through the class action regime and the funding of that pool to manage risk. These regimes are covered by the requirements for an AFSL.*
>
> [Footnotes omitted]

2.26 It follows that the litigation funding market should be subject to similar obligations, or, as is submitted by LFA above, that litigation funders should be required to hold an AFSL.

3. Contingency fees

Introduction

3.1 The Inquiry's proposal to lift the ban on contingency fees follows similar recommendations by the Productivity Commission[23] and the Victorian Law Reform Commission.[24] Those recommendations were not confined to class action proceedings but were subject to certain exclusions.

3.2 The debate concerning whether lawyers should be permitted to enter into contingency fee arrangements has received considerable engagement from a range of stakeholders, including plaintiff law firms,[25] defendant law firms,[26] insurers,[27] litigation funders,[28] professional associations,[29] and industry bodies.[30] It is clear from those submissions that there are a wide range of opinions about whether the ban on contingency fees should be lifted, and if so, what protections should be in place.

3.3 There are differences of opinion amongst LFA member firms as to whether the ban on contingency fees should be lifted for class action proceedings (or at all), and if so, what limitations should be imposed. Some within LFA member firms also have reservations about whether:

(a) the professed benefits of contingency fees to group members, and access to justice more broadly, are likely to be achieved should they be permitted, and

(b) the potential conflicts of interest created by contingency fees are capable of being adequately managed.

3.4 Notwithstanding the differences of opinion amongst LFA member firms, LFA wishes to make a positive contribution to the Inquiry by addressing what LFA considers to be the minimum regulation required, should contingency fees be introduced.

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[23] Productivity Commission, *Access to Justice Arrangements* (Inquiry Report No 72, Vol 1, 2014).

[24] Victorian Law Reform Commission ('VLRC'), *Access to Justice— Litigation Funding and Group Proceedings*, Report (March 2018).

[25] Slater and Gordon, Submission No 28 to VLRC (October 2017); Phi Finney McDonald, Submission No 15 to VLRC (22 September 2017); Maurice Blackburn, Submission No 13 to VLRC (September 2017).

[26] Allens, Submission No 12 to VLRC (September 2017); Ashurst, Submission No 27 to VLRC (6 October 2017).

[27] Insurance Council of Australia, Submission No 29 to VLRC (10 October 2017).

[28] IMF Bentham, Submission No 25 to VLRC (6 October 2017); Litigation Funding Solutions, Submission No 11 to VLRC (22 September 2017).

[29] Law Council of Australia, Submission No 21 to VLRC (4 October 2017); Commercial Bar Association of Victoria, Submission No 34 to VLRC (31 October 2017).

[30] Chartered Accountants Australia and New Zealand, Submission No 4 to VLRC (20 September 2017).

3.5 In this regard, LFA notes a statement made by Simone Degeling, Michael Legg and James Metzger to the VLRC (and quoted in the Discussion Paper):

> …the main issue is not embracing contingency fees but instead the more difficult issue of how to ensure that fees are charged in an appropriate manner that is fair to both lawyer and client".[31]

Proposed regulatory measures

3.6 The reality of permitting contingency fees is that it enables lawyers to, in effect, purchase a share in the litigation and a direct financial interest in their client's case. The contingency fee will entitle the lawyer to part of their client's reward and this entitlement carries with it a real risk that lawyers put their own financial interests ahead of their clients.

3.7 Contingency fees may also create a real risk of conflict with the lawyer's duties to the Court. For example, there may be situations where a lawyer must cease to act for a client in order to comply with their professional obligations, but in a contingency fee agreement, this ceasing to act may necessitate forgoing payment.

3.8 LFA echoes a recent submission to the VLRC by one of its constituent members, Allens, that lifting the ban on contingency fees gives rise to potential conflicts of interest between the lawyer and the client that threatens the balance the High Court sought to achieve in *Campbells Cash and Carry Pty Ltd v Fostif Pty Ltd* (2006) 229 CLR 386.[32] This is because contingency fees threaten to compromise the lawyer's independence, where such independence in ordinary third-party funded litigation acts as a 'bulwark' for the client against the commercial interests of the funder. As was observed in another submission to the VLRC by a constituent member of LFA, Ashurst, 'the tri-partite structure of lawyer, client (or class) and funder avoids some of these issues and provides a check on others.'[33]

3.9 Accordingly, LFA considers that lifting the ban on contingency fees should only occur in a carefully regulated environment.

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

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[31] Simone Degeling, Michael Legg and Dr James Metzger, Submission No 9 to VLRC, *Litigation Funding and Group Proceedings* (22 September 2017), 18.

[32] At [93], per Gummow, Hayne and Crennan JJ.

[33] Allens, above n 26, 10.

costs order.

3.10 LFA shares the Inquiry's concern that there is currently a 'double up' in funded class actions, in that group members are not only required to pay a funding commission to a litigation funder (usually around 30% of the settlement sum), but also legal fees (often including an uplift on those fees of up to 25%). LFA observes that issues with the double up have become more pointed of late in settlement approvals of funded class actions in the Federal Court. For example:

(a) *Money Max Int Pty Limited (Trustee) v QBE Insurance Group Limited* [2018] FCA 1030: funding commission of 23.2% of the gross settlement amount, plus legal costs of approximately 16.5% of the gross settlement amount.

(b) *Caason Investments Pty Limited v Cao (No 2)* [2018] FCA 527: funding commission of 30% of the gross settlement amount (by way of late-stage common fund order, originally 35-40%), plus legal costs of approximately 40% of the gross settlement amount.

(c) *Clarke v Sandhurst Trustees Limited (No 2)* [2018] FCA 511: funding commission of 30% of the gross settlement amount, plus legal costs of 29.2% of the gross settlement amount.

3.11 As can be seen from the above cases, it is not uncommon for legal costs to approach parity with the funding commission, leaving group members with less than 40% of the gross settlement amount in some cases.

3.12 For the above reasons, LFA supports the Inquiry's proposal that the following limitations should apply:

(a) 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, and

(b) a contingency fee cannot be recovered in addition to professional fees for legal services charged on a time-cost basis.

3.13 Consistent with the risk-reward justification for contingency fees, LFA supports the ALRC's proposal that under a contingency fee agreement, lawyers must advance the costs of disbursements.

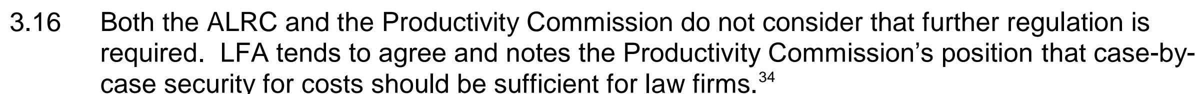
3.14 For a similar reason, LFA considers that the representative plaintiff's exposure to security for costs and adverse costs orders must also be addressed, and could be addressed in one or more of the following ways:

(a) the plaintiff law firm could be required to indemnify the representative plaintiff,

(b) the plaintiff law firm could be required to enter into an appropriate after the event insurance policy, or

(c) amending the rules of the Court so that the discretionary power to award costs against non-parties in the interests of justice also applies to lawyers charging contingency fees.

3.15 Of course, this raises the issue as to whether lawyers should be subject to capital adequacy requirements. It may also introduce further potential for conflicts between the interests of lawyers and their clients.



3.16 Both the ALRC and the Productivity Commission do not consider that further regulation is required. LFA tends to agree and notes the Productivity Commission's position that case-by-case security for costs should be sufficient for law firms.[34]

> **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.
>
> **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.
>
> If Proposal 5–2 is adopted, this power should also apply to contingency fee agreements.

3.17 If contingency fees are permitted for class actions, LFA supports Proposals 5-2 and 5-3.

3.18 In order for Proposal 5-3 to be workable:

(a) approval for any contingency fee agreement should be sought at the commencement of the proceeding, and

(b) any contingency fee agreement should be subject to further consideration by the Court at the time of settlement approval or judgment, having regard to the relevant circumstances known at that time.

3.19 LFA notes the VLRC's proposal that the mechanism by which contingency fees would be approved and supervised by the court in representative proceedings is a common fund order, following an application by the representative plaintiff's lawyers to be appointed the 'funder' of the class action. The plaintiff would apply to the court for a common fund for a 'litigation services' fee, which is court-approved and calculated as a percentage of any recovered amount and liability for payment is shared among all class members if the litigation is successful. The litigation services for which the fee is payable would include legal costs, disbursements and all costs in connection with indemnifying the representative plaintiff against adverse costs and responding to a security for costs order if necessary.[35]

3.20 LFA considers this VLRC proposal has merit, as it is likely to reduce 'book-build' costs, thereby increasing recovery to group members.

> **Question 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.

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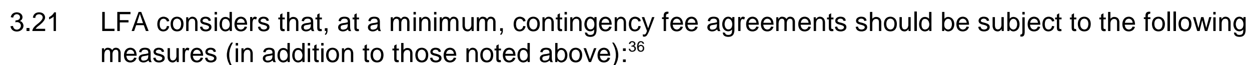
[34] Productivity Commission, above n 23, 636.

[35] VLRC, above n 24, [3.74].



3.21 LFA considers that, at a minimum, contingency fee agreements should be subject to the following measures (in addition to those noted above):[36]

(a) provision for the representative plaintiff may obtain independent legal advice in relation to the contingency fee agreement, at the cost of the lawyers seeking to benefit from that agreement,

(b) a cooling off period for group members entering into contingency fee agreements,

(c) comprehensive disclosure requirements, including:

(i) specifying the contingency fee,

(ii) defining 'success',

(iii) disclosing all potential costs (including any after the event premiums) and the right to obtain independent advice before the agreement is finalised,

(iv) identifying the dispute resolution mechanism in the event of a disagreement between the client and the lawyers, and

(v) identifying the waterfall for priority of payments,

(d) disclosure of any contingency fee agreements from the outset of a class action proceeding to the Court, as well as to group members and the defendant's lawyers, and

(e) a rule that any costs awarded in favour of the representative plaintiff are applied in favour of the contingency fee.

3.22 The question of statutory caps has generated much discussion, with various types proposed, including: a blanket cap on the amount of an award that could be retained by a lawyer, or; caps on a sliding scale.

3.23 The challenge posed by caps is both their inflexibility (as it will not reflect differences in the risks of individual cases) and the fact that the cap will more than likely become the standard amount charged a contingency fee agreement (this is consistent with the practice of uplift fees being set at the maximum limit of 25%).

3.24 If contingency fee agreements are to be permitted only with leave of the Court, and the Court retains the power to reject, vary or set the commission rate in contingency fee agreements based on the individual circumstances of the case, LFA considers that Court oversight should provide sufficient protection for group members.

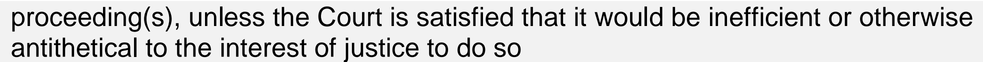
4. Competing class actions

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

[36] DLA Piper has made a separate submission that addresses Question 5-2.



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.

4.1 Multiple claims, with similar classes and issues, being brought against a common defendant is an increasingly common feature of the Australian class actions market. Due to the overlapping nature of such claims, defendants incur significant cost in undertaking repetitious work responding to each claim. They also often result in substantial confusion, delay, and unnecessary costs for the Court.

4.2 LFA supports the proposal for the mandatory consolidation of competing class actions by the Court. It is important that the Court has the flexibility and power to deal with multiple overlapping claims, given the substantial confusion, delay, and unnecessary costs they incur. It is also important that the issue be addressed through legislative reform in order to provide greater certainty and consistency of approach.

4.3 LFA considers that a consolidation hearing is preferable, whereby multiple claims can be considered and case managed to a point where only one proceeding, representing all concerned parties, continues. The consolidation hearing would also serve the purpose of ensuring that the lead plaintiff has a meaningful role in proceedings and is suitable for the role.

4.4 A consolidation hearing process should include the following key features:

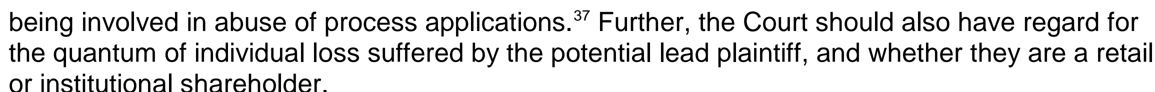
(a) Proceedings should all be filed as 'open' classes, and should be assigned to a case management judge. This will ensure that, from the outset, all potential group members are involved and that proceedings are run as efficiently as possible.

(b) Shortly after proceedings are filed, the parties should have to return before the Court for the case management judge to consider a form of order, a Notice of Filing, for distribution to group members. The notice would set out the criteria for membership, and the key allegations to be pleaded. Further, given the importance of ensuring the lead plaintiff is given a meaningful role in proceedings and is suitable for such a role, it is advisable that all potential group members be given the opportunity to apply for the position.

(c) As soon as practicable after notification occurs, the Court should hold a consolidation hearing to resolve the questions raised by the Notice of Filing and further consider how best to proceed. The consolidation hearing would occur without prejudice to cross-vesting rights and at this point, claims that wish to proceed in alternative jurisdictions should also be heard.

(d) In addition to considering whether more than one proceeding is appropriately positioned to remain on foot, the Court should determine the identify of a lead plaintiff, consider whether to make orders regarding a common fund, and approve a Notice of Participation to group members which effectively operates as an early class closure mechanism. The Court should also keep a record of the details of all proceedings on a national register.

4.5 As part of determining the suitability of the lead plaintiff, there should be presumption of unsuitability if a person has served as lead plaintiff in multiple shareholder class actions within five years. Such restrictions are necessary due to vexatious litigants and claimants repeatedly



being involved in abuse of process applications.[37] Further, the Court should also have regard for the quantum of individual loss suffered by the potential lead plaintiff, and whether they are a retail or institutional shareholder.

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?

4.6 LFA does not support the amendments proposed at Question 6-1. There does not appear to be a jurisprudential basis for the proposed approach, and it disregards that claimants may prefer differences in jurisdictions. An alternative is to grant jurisdiction to the Court in which the first claim is filed, noting that cross-vesting claims will be heard at the consolidation hearing. The risk that such an approach would induce a 'race to the Court' is likely to be minimal as competing claims are rarely ready for filing at the same time. Professor Morabito has observed that, where multiple claims have been filed in respect of a common defendant, the median period between the filing of the first and last (usually the second) claim was 125 days, and the average was 254 days.[38]

4.7 Additionally, group members who opt-out of one class should not be permitted to commence or participate in subsequent aggregate proceedings, in respect of the same subject matter and defendant, without leave of the Court. By conferring discretion on the Court, LFA considers the default position against permitting alternative claims being brought ensures that the current regime cannot be circumvented.

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.

4.8 LFA supports Proposal 6-2, however it is noted that providing further case management procedures in the practice note should not be adopted as an alternative to the legislative amendments at Proposal 6-1.

5. Settlement confidentiality

5.1 In a funded class action, it is often the litigation funder and, to a lesser extent, the lawyers acting for the plaintiff, that determine, or at the very least have significant influence over, decisions in relation to settlement. Accordingly, the Court has an important role to play in protecting the interests of class members, particularly those who may not have a direct relationship with the funder and/or lawyer.

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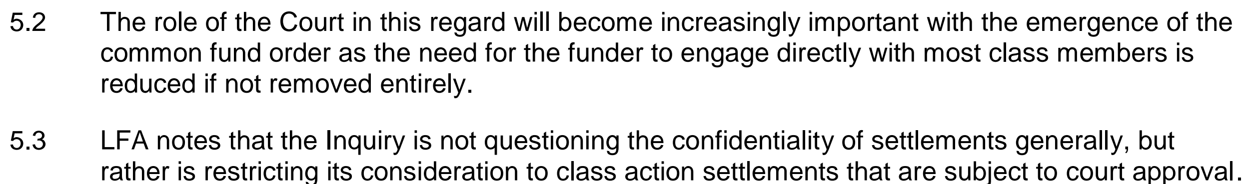
[37] *Melbourne City Investments Pty Ltd v Treasury Wine Estates Limited* (2017) 252 FCR 1; *Walsh v WorleyParsons* [2017] VSC 292; *Melbourne City Investments v UGL Limited* [2017] VSCA 128.

[38] Vince Morabito, "Competing class actions and comparative perspectives on the volume of class actions litigation in Australia", An Evidence-Based Approach to Class Actions Reform in Australia (Monash Business School, 6th ed, 11 July 2018), 14.



5.2 The role of the Court in this regard will become increasingly important with the emergence of the common fund order as the need for the funder to engage directly with most class members is reduced if not removed entirely.

5.3 LFA notes that the Inquiry is not questioning the confidentiality of settlements generally, but rather is restricting its consideration to class action settlements that are subject to court approval.

Settlement confidentiality generally

5.4 As a general rule, LFA supports the confidentiality of settlements for a number of reasons.

5.5 First, it is in the public interest for litigation to be settled as quickly as possible. Unnecessary costs are avoided and the burden on courts, a public cost, reduced. Maintaining confidentiality of settlements assists in the early resolution of claims. However, that would not be the case if the terms of a settlement were made public given the potential to encourage further claims.

5.6 Second, defendants settle proceedings for a variety of reasons that extend well beyond questions of legal liability. For example, a claim may well be settled notwithstanding the absence of any liability, in order to avoid the cost and disruption associated with defending the proceedings. Similarly, the quantum of a settlement may not reflect the actual liability of the defendant. A premium may be paid to resolve a matter because of the impact a claim - albeit without merit - may have on a corporation and its ongoing business operations. If confidentiality cannot be maintained there will be greater pressure on corporations to simply leave the determination to the Court.

5.7 However, in the case of class actions, LFA acknowledges the need for disclosure to the court which will inevitably result in some level of public disclosure.

Transparency of litigation funding arrangements

> **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?

5.8 Little is publically known about the terms on which many cases are funded by litigation funders. It is often difficult, if not impossible, to determine the real cost to class members in terms of the litigation funder's fees and charges from the approval decision. This is not in the public interest as it effectively operates to inhibit competition and an informed market.

5.9 LFA submits that the Court's decision in a settlement approval hearing should include sufficient information to allow the reader to ascertain:

(a) the fees and charges paid to the litigation funder, and

(b) the percentage of the compensation or damages received by the class that has been deducted to pay:

(i) the litigation funder's commission, fees and charges however described, and

(ii) legal costs and disbursements.

6. Collective 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.

Question 8-1

What principles should guide the design of a federal collective redress scheme?

6.1 LFA supports the Inquiry's observation that the time and expense associated with class action litigation warrants consideration of alternative means of collective redress that may achieve swifter and more effective outcomes for both claimants and potential defendants.

6.2 It is important that potential defendants' interests be given appropriate consideration in the design of any such scheme. In particular, a scheme must provide certainty and finality for the potential defendant by addressing all potential claims on a 'once and for all' basis. In those circumstances, while LFA supports Proposal 8-1 to the extent that it recommends consideration of a federal collective redress scheme, we are firmly of the view that any such scheme should operate on an opt-out (rather than opt-in) basis.

6.3 In relation to the principles that should guide the design of a federal collective redress scheme, we consider that, for such a scheme to provide a viable alternative to class action litigation and properly balance the interests of claimants and potential defendants, it should:

(a) provide finality and certainty for the potential defendant implementing the scheme,

(b) be voluntary for the potential defendant,

(c) not require the potential defendant to make an admission of liability (or any other admissions),

(d) allow communications with the regulator to remain confidential, and

(e) give rise to the potential for lower regulatory penalties in recognition of the potential defendant's willingness to voluntarily provide redress.

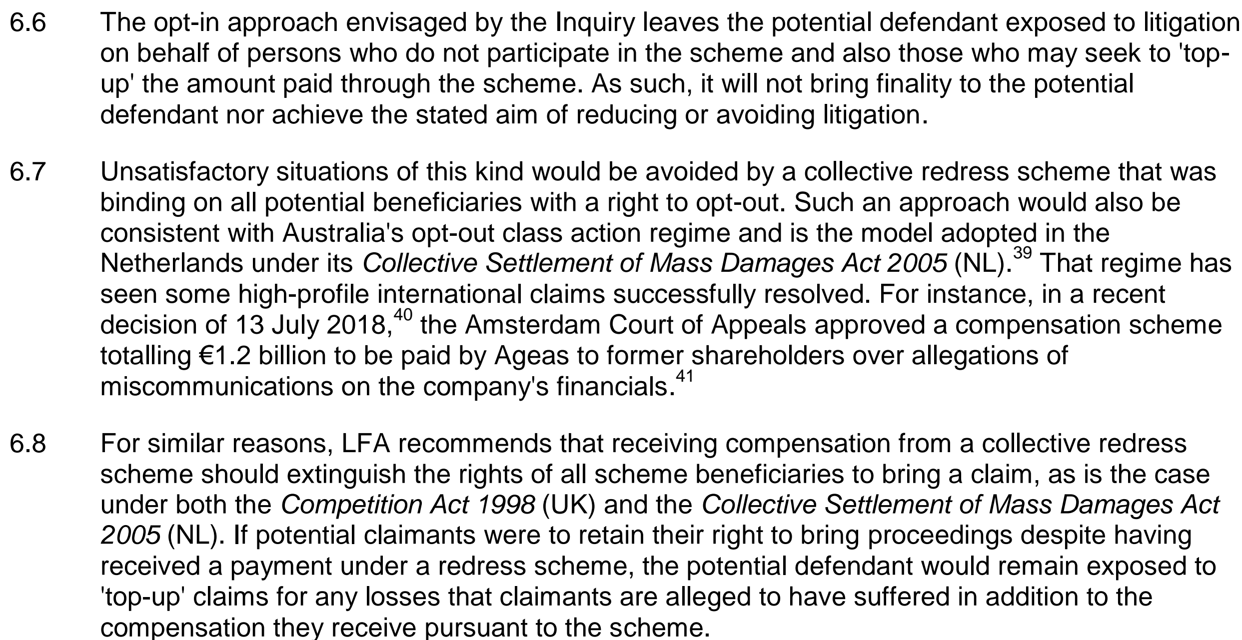
6.4 Each principle is addressed below.

Finality and certainty for the potential defendant

6.5 As noted above, LFA considers that any redress scheme must provide finality and certainty for the potential defendant by addressing all potential claims on a 'once and for all' basis. This requires that the scheme:

(a) is binding on all persons affected by the conduct in question, without requiring them to opt-in to the scheme, and

(b) extinguishes the rights of all such persons to bring claims in respect of the conduct in question.



6.6 The opt-in approach envisaged by the Inquiry leaves the potential defendant exposed to litigation on behalf of persons who do not participate in the scheme and also those who may seek to 'top-up' the amount paid through the scheme. As such, it will not bring finality to the potential defendant nor achieve the stated aim of reducing or avoiding litigation.

6.7 Unsatisfactory situations of this kind would be avoided by a collective redress scheme that was binding on all potential beneficiaries with a right to opt-out. Such an approach would also be consistent with Australia's opt-out class action regime and is the model adopted in the Netherlands under its *Collective Settlement of Mass Damages Act 2005* (NL).[39] That regime has seen some high-profile international claims successfully resolved. For instance, in a recent decision of 13 July 2018,[40] the Amsterdam Court of Appeals approved a compensation scheme totalling €1.2 billion to be paid by Ageas to former shareholders over allegations of miscommunications on the company's financials.[41]

6.8 For similar reasons, LFA recommends that receiving compensation from a collective redress scheme should extinguish the rights of all scheme beneficiaries to bring a claim, as is the case under both the *Competition Act 1998* (UK) and the *Collective Settlement of Mass Damages Act 2005* (NL). If potential claimants were to retain their right to bring proceedings despite having received a payment under a redress scheme, the potential defendant would remain exposed to 'top-up' claims for any losses that claimants are alleged to have suffered in addition to the compensation they receive pursuant to the scheme.

Implementation of a scheme must be voluntary for the potential defendant

6.9 While LFA accepts that the combination of public enforcement and private damages actions can reduce the overall costs of remedying wrongdoings, it will not always be appropriate for a potential defendant to implement a scheme when a regulator has formed the view that its conduct has not met certain standards.

6.10 It is fundamental to our justice system that a defendant should have the right to have the question as to its liability or the quantum of any alleged losses tested by a court. There is further public benefit in such cases being brought before the courts as they can provide guidance on the proper interpretation of the law and can thus inform future conduct.

6.11 For that reason, it is essential that a redress scheme not be forced upon a potential defendant but rather be a mechanism that is available on a voluntary basis. This is the approach of the scheme mechanism available under the *Financial Services and Markets Act 2000* (UK), and also under similar schemes in the Netherlands[42] and Latvia.[43]

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[39] Schemes approved under that Act are binding on all potential claimants, whose rights to bring a cause of action for further compensation are extinguished unless they opt out of the settlement before a deadline set by the approving court. Furthermore, the agreement can stipulate that the rights of group members who have not claimed for compensation under the scheme within a period of at least one year are extinguished.

[40] Ageas B.V. 2018, 'Press release: Fortis settlement declared binding,' Ageas B.V., 13 July 2018, <https://www.ageas.com/newsroom/fortis-settlement-declared-binding>.

[41] Financial Times 2018, 'Aegas to pay Fortis shareholders €1.2 billion over financial crisis,' Financial Times, 15 March 2016, <https://www.ft.com/content/fa130ada-e9d2-11e5-888e-2eadd5fbc4a4>.

[42] Collective Settlement of Mass Damages Act 2005 (NL) ('Wet Collectieve Afwikkeling Massaschade' ("WCAM")) ss 7:709-7:910 <http://wetten.overheid.nl/BWBR0005290/2009-03-25/1>; Bart Krans, 'The Dutch Act on collective settlement of mass damages' (2014) 27 Global Business & Development Law Journal, <http://www.mcgeorge.edu/Documents/Publications/05_Krans_27_02.pdf>.

[43] Consumer Rights Protection Act 1999 (LV) ('Patērētāju tiesību aizsardzības likums'), translated Consumer Rights Protection Act 1999 (LV) at <http://www.wipo.int/edocs/lexdocs/laws/en/lv/lv012en.pdf>.

No admission of liability

6.12 The option to implement a redress scheme should not require the potential defendant to make any admission of liability or of any particular facts in relation to its conduct.

6.13 In our opinion, requiring any such admissions would be both an unnecessary and counter-productive having regard to the objectives of a collective redress scheme. It is unnecessary in that the purpose of a redress scheme would be to provide redress rather than attribute culpability (and one is not necessary for the other). It is counterproductive in that it is likely to be significant obstacle to a potential defendant being willing to implement a scheme – even more so if a scheme did not resolve its liability once and for all.

6.14 Requiring an admission was identified as a 'fundamental shortcoming' of the Latvian *Consumer Rights Protection Act 1999* (LV)[44] in a recent European Commission report on the status of collective redress in the European Union.[45]

Confidentiality

6.15 LFA recommends that any information shared with regulators while addressing the conduct that ultimately results in a collective redress scheme be treated confidentially.

6.16 Claimants who decide not to participate in the collective redress scheme and instead pursue their claim individually or collectively should not be able to use information provided to the regulator to advance their position in litigation.

6.17 Consistent with this approach, the United Kingdom Competition and Markets Authority ('CMA') has determined that all communication with the board which is to set up the scheme is on a 'without prejudice' basis, and cannot be adduced as evidence in court proceedings.[46] Similarly, the CMA will generally treat applications for approval of a scheme as confidential.[47]

Reduction of regulatory penalty

6.18 LFA acknowledges (and agrees with) the Inquiry's suggestion that the possibility of a lower regulatory penalty in recognition of a potential defendant's willingness to enter to into a voluntary redress scheme would be an important incentive in encouraging potential defendants to take that step.

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[44] European Commission 2018, State of Collective Redress in the EU in the Context of the Implementation of the Commission Recommendation, 746, <http://ec.europa.eu/newsroom/just/document.cfm?action=display&doc_id=50236>.

[45] European Commission 2018, State of Collective Redress in the EU in the Context of the Implementation of the Commission Recommendation, 746, <http://ec.europa.eu/newsroom/just/document.cfm?action=display&doc_id=50236>.

[46] Competition and Markets Authority 2015, Guidance on the Approval of Voluntary Redress Schemes for Infringements of Competition Law, 2015, 33 at 2.72-2.74, <https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/453925/Voluntary_redress_schemes_guidance.pdf>.

[47] Competition and Markets Authority 2015, Guidance on the Approval of Voluntary Redress Schemes for Infringements of Competition Law, 2015, 38 at 3.8, <https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/453925/Voluntary_redress_schemes_guidance.pdf>.

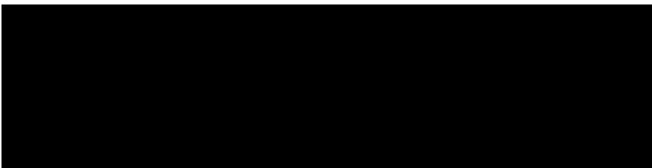
6.19 In this regard, we note that the United Kingdom CMA has indicated that it will grant a reduction of fines by up to 20% for companies who voluntarily propose redress schemes.[48]

7. Conclusion

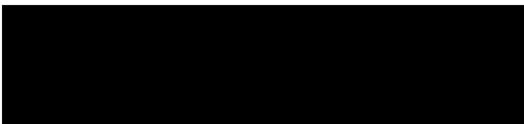
7.1 LFA appreciates the opportunity to provide a submission on the Discussion Paper.

7.2 Please do not hesitate to contact me if the points above require clarification or if LFA can provide further information that will be of assistance.

Yours faithfully



Mitch Hillier
Executive Director
Law Firms Australia



[48] Competition and Markets Authority 2015, Guidance on the Approval of Voluntary Redress Schemes for Infringements of Competition Law, 2015, 46 at 3.30, <https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/453925/Voluntary_redress_schemes_guidance.pdf>.