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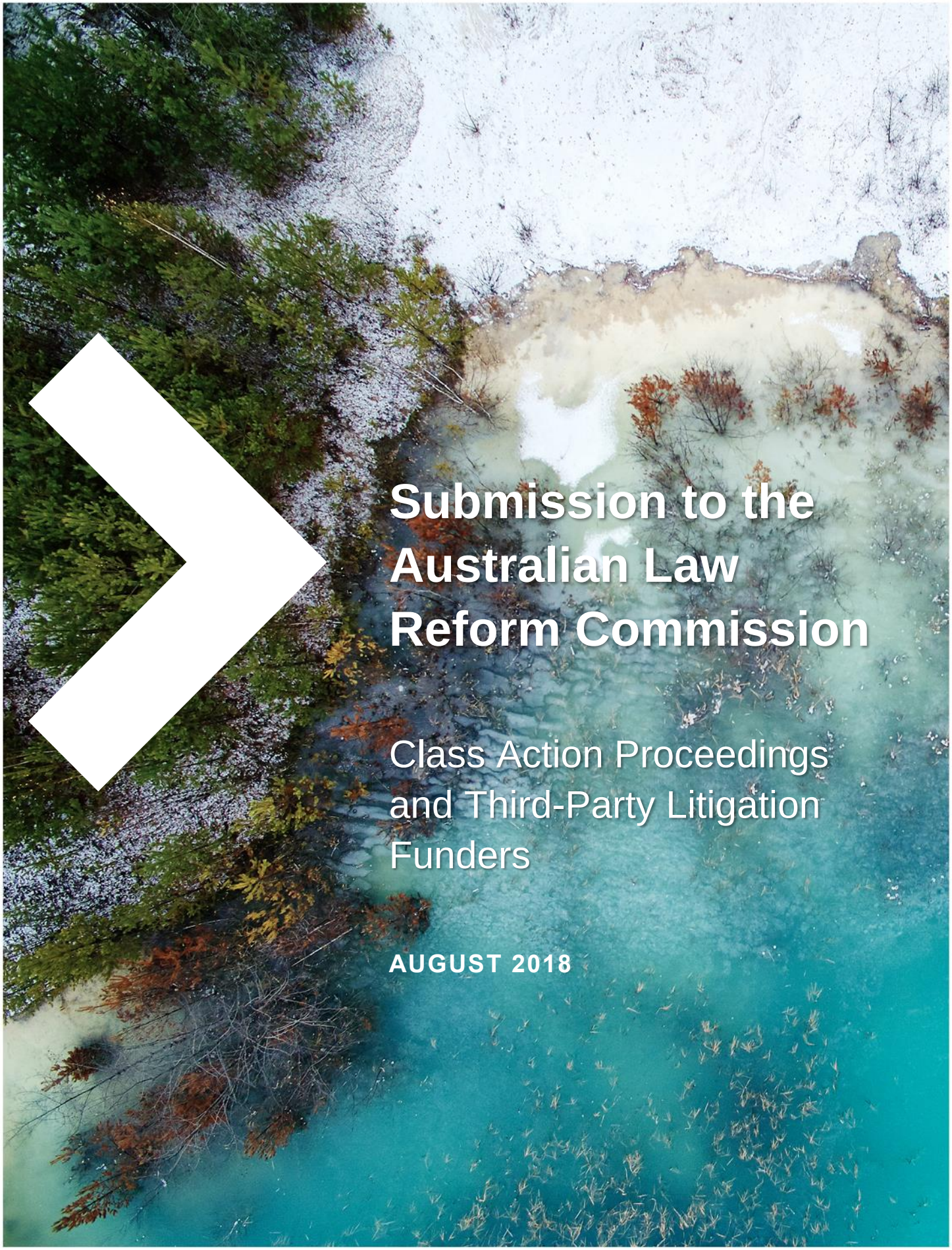

Submission to the Australian Law Reform Commission

Class Action Proceedings and Third-Party Litigation Funders

AUGUST 2018

Contents

Introduction

1 We appreciate this opportunity to make submissions in response to the Australian Law Reform Commission's 'Inquiry into Class Action Proceedings and Third Party Litigation Funders'.

2 The Allens disputes team has a long history of acting for defendants in class actions. This has included more than thirty class actions in the Federal and state courts across a broad range of contexts including shareholder, product liability, consumer protection, financial products, cartel, environmental damage, natural disaster, human health and employee rights. We have also been involved in the ground-breaking claims that have shaped modern class actions practice – including the first major funded class action, the first 'closed class' class action, the first shareholder class action to go to trial, the first cartel class action, the class action in which 'funding equalisation' was first ordered and the first case in which a common fund order was made. This experience gives a unique perspective from which to comment on the issues raised by the Inquiry.

3 From this vantage point, we have seen the nature of the class actions landscape fundamentally change over the course of the last 15 years.[1] While we haven't seen the 'proliferation' of class actions many have feared, class action filings have steadily increased and there can be no doubt that class actions practice has become increasingly entrepreneurial. Indeed, as we see it, the defining feature of today's class actions environment is plaintiff lawyer and funder entrepreneurialism. Put simply, more than ever before, class actions are seen as lucrative profit-making opportunities for plaintiff lawyers and third party funders.

4 Against this background, the Inquiry presents an important (and timely) opportunity to take a step back and assess whether reform is required to ensure that the class action regime continues to serve the purposes for which it was enacted – access to justice, finality for defendants and efficient use of judicial resources. As the Chief Justice of the Federal Court has recognised, it is important that class actions continue to provide social utility and are run for the benefit of litigants – not funders and lawyers.[2] Importantly, litigants in this context means both plaintiffs and defendants.

5 Given our long history of representing class action defendants, we are particularly concerned to see that the interests of defendants are given due consideration in this process. In our experience, defendant interests are often overlooked in the quest for the more popular (and arguably easier) objective of access to justice. However, faithfulness to the objectives of the regime requires that the interests of both sides be given fair and balanced consideration.

6 We have responded to the issues raised by the Commission's Discussion Paper in respect of which our experience qualifies us to sensibly contribute to the discussion. In summary, those issues and the views we have expressed include the following:

(a) **Chapter 1 – Continuous disclosure review:** We welcome and support the Commission's proposal that the Australian Government should commission a review of the legal and economic impact of the continuous disclosure obligations on listed companies in light of the evolving shareholder class action environment. Indeed it is difficult to see how, after almost twenty years of shareholder class action experience, it could be suggested that these issues are not of sufficient importance to the conduct of business in this country to warrant an informed and balanced review of whether the continuous disclosure regime, and the private right of action arising from a possible breach, are serving the interests of shareholders and the broader business community.

[1] Allens '25 Years of Class Actions: Where are we up to and where are we headed' (25 March 2017): https://www.allens.com.au/pubs/class/papclass27mar17.htm.

[2] Justice James Allsop, *Class Actions* (speech at Law Council of Australia Forum, 13 October 2016).

(b) **Chapter 3 – Regulation of litigation funders:** We support the Commission's recommendation that a bespoke licensing regime be introduced for the litigation funding industry. We support modelling that regime on the Australian Financial Services Licence scheme, supplemented by specific requirements as to capital adequacy and conflict management. Licensees should also be subject to a regular audit program to ensure that the regime is not a 'dead letter'. We also propose that litigation funders should be subject to a duty of good faith.

(c) **Chapter 4 – Conflicts of interest:** The conflicts that arise in the class actions context are significant and pervading, and pose the biggest challenge to the integrity of the class actions regime. The issue that looms largest for us in this respect is the fact that third party funders are much more likely to be the 'repeat clients' of plaintiff law firms than the group members they represent. In our observation, this has given rise to the prospect of the commercial interests of funders being preferred over the interests of group members – to the detriment of group members, defendants and the regime. Accordingly, we support the Commission's attempts to address these issues but are concerned that its proposals do not go far enough to facilitate real change. In our opinion, this can only be achieved by the Court taking an active and inquisitive role in supervising the management of the conflicts in the matters before it.

(d) **Chapter 5 – Legal fees and commissions:** In this section, we have responded to the Commission's recommendation that contingency fees be permitted in class actions, and also certain recommendations in relation to the Court's powers in respect of legal fees and funding commissions:

(i) **Contingency fees:** Lifting the ban on contingency fees (even in the limited circumstances proposed) would be a very significant development for the legal system as a whole. In our opinion, it is a step that should not be taken lightly given the potential for it to further exacerbate the conflicts of interest issues discussed above. This is particularly the case in circumstances in which there is no evidence (and, in our view, no reason to think) that doing so would improve access to justice in the class action context.

We recognise, however, that there is momentum in favour of permitting contingency fee arrangements for plaintiff lawyers in certain contexts. If contingency fee arrangements are to be allowed in class actions, we agree with the Commission that this must be in a controlled manner and subject to approval (and close supervision) by the Court. It is also imperative that the 'loser pays' rule remains in place as a key disincentive to the bringing of purely speculative claims.

(ii) **Court's powers re fees and commissions:** We support the Commission's recommendation that the Court be given the power to reject, vary or set the commission rate in third party funding arrangements and, if they are permitted, contingency fees arrangements.

(e) **Chapter 6 - Competing class actions:** Competing class actions have a number of undesirable consequences. In most cases, there is little real justification for paying multiple sets of lawyers to run multiple claims when class members could be effectively represented in a single claim by a single legal team. Aside from the additional prosecution costs, competing class actions also significantly increase the defence cost burden, give rise to confusion (and in some cases significant stress) for group members, and impose an additional burden on the Court. For those reasons, there is a pressing need for the Court to take a proactive approach to managing competing class actions. Accordingly, we strongly support the Commission's recommendations to implement a procedure that would (in the

majority of circumstances) result in a single class action proceeding when competing claims are filed.

(f) **Chapter 7 - Settlement approval:** In this section, we have responded to the Commission's recommendations in relation to costs referees and confidentiality in the settlement context:

(i) **Costs referees:** We support the Commission's proposal in respect of the appointment of costs referees to assess the reasonableness of costs charged in a class action prior to settlement approval, but say that, in order to be effective, the costs referees should also perform that role throughout the matter.

(ii) **Confidentiality:** There is no reason for the terms of class action settlements to be made public any more than is necessary for the purposes of the approval process, which can be considered by the Court on a case-by-case basis. As the Court has acknowledged, class action litigation is private litigation between a defendant and group of individuals or entities. So long as the terms can be made available to the group members, there is no broader public interest served by the publication of settlement terms.

(g) **Chapter 8 - Federal collective redress:** We agree with the Commission'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. It is, however, important that the 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. Other key criteria for any such scheme include: that it be voluntary for the potential defendant; not require the potential defendant to make an admission of liability; allow communications with the regulator to remain confidential; and give rise to the potential for lower regulatory penalties in recognition of the potential defendant's willingness to voluntarily provide redress.

7 Our objective in making these submissions is not to devalue the valuable role and achievements of the class action regime – the regime is an important part of our civil justice system which has successfully delivered access to justice to claimants who have suffered loss in circumstances in which seeking individual redress would not have been possible or practical; and also facilitated defendants addressing exposure through a single process. Instead, our focus is on advocating for appropriate checks and balances to ensure that the regime continues to deliver those results and is not compromised by unfettered commercialisation.

8 To be clear from the outset, we do not see commercialisation (or entrepreneurialism) as problematic per se – indeed, the courts and legislatures have long recognised that it is an essential ingredient in facilitating access to justice. It is, however, only a means to an end and should only be permitted to the extent that it facilitates, rather than undermines, the objectives of the class actions regime.

9 In summary, we consider that reform is required to ensure that the class action regime continues to serve the very important objectives for which it was enacted. In our opinion, this requires a renewed focus on balancing the interests of claimants and defendants and more robust processes for moderating entrepreneurial forces when they do not serve those interests and/or the interests of justice more generally.

10 In our opinion, any reform to the federal regime would ideally be enacted in consultation with the state jurisdictions.

Chapter 1: Review of impact of continuous disclosure obligations in light of shareholder class action activity

1 In this section we have responded to the Proposal 1-1 that the Australian Government commission a review of the legal and economic impact of the continuous disclosure obligations of listed companies and those relating to misleading and deceptive conduct contained in the Corporations Act and ASIC Act with regard to:

(a) the propensity for companies to be the target of funded shareholder class actions;

(b) the value of the investments of shareholders at the time when that entity is the target of the class action; and

(c) the availability and cost of directors' and officers' liability cover within the Australian market.

Introduction

2 Shareholder class actions were not an area of focus when the Commission released its Grouped Proceedings report that led to the adoption of Australia's first class action regime by the Federal Court in 1992.[3] Today, however, Australia is considered one of the most favourable jurisdictions in the world for aggrieved shareholders – and their lawyers and litigation funders – to pursue listed companies for alleged contraventions of market disclosure obligations.

3 In recent times, it has become a fact of corporate life that, after any significant share price drop, there is likely to be an announcement by at least one law firm (and increasingly multiple firms) that they are investigating the company's conduct and inviting shareholders to register their interest in participating in a class action. Should a class action ultimately be filed, experience suggests that the class and the company are in for years of drawn-out litigation[4] which is usually brought to an end by a settlement.

4 Unsurprisingly in these circumstances, shareholder class actions are having a significant (and draining) effect on listed entities and their insurers. Aside from the obvious costs (a significant proportion of which 'leaks' to lawyers and funders), it is also becoming increasingly apparent that shareholder class action risk is attracting a disproportionate level of attention at board level and changing the approach to continuous disclosure obligations in ways that do not necessarily align with the objectives of the disclosure regime.

5 Against that background, we welcome and support the Commission's proposal. Indeed it is difficult to see how, after almost twenty years of shareholder class action experience, it could be suggested that these issues are not of sufficient importance to the conduct of business in this country to warrant an informed and balanced review of whether the continuous disclosure regime, and the private right of action arising from a possible breach, are serving the interests of shareholders and the broader business community.

6 For the reasons discussed below and elsewhere in this submission, as we see it, the objectives of both the class actions and continuous disclosure regimes are at serious risk of being comprised by the way in which the practices surrounding shareholder class actions have evolved (and continue to evolve). In particular, we are concerned that, without reform of the private right of action arising

[3] Australian Law Reform Commission, 'Grouped Proceedings in the Federal Court' [1988] ALRC 46. Shareholder actions are, however, given as an example of a multiple wrong situation where grouped proceedings could be used (p.33).

[4] Research by Prof. Vince Morabito suggests that the average duration of a shareholder class action in the Federal Court of Australia is 931 days (approximately 2.5 years): see Vince Morabito, 'An empirical study of Australia's class action regimes, Fourth Report: Facts and figures on twenty-four years of class actions in Australia' (Monash Business School, Department of Business Law and Taxation, August 2016), p.10.

from the alleged breach of continuous disclosure obligations, the continuation of current trends will be detrimental to:

(a) shareholders;

(b) the efficacy of the class actions regime more generally; and

(c) the efficacy of the continuous disclosure regime.

7 We have elaborated on our reasons for supporting the Commission's proposal in the paragraphs that follow. In order to provide further context to inform the consideration of these issues, we have also provided an overview of the current shareholder class action environment and an assessment of the forces driving that environment.

The current shareholder class action environment

8 While the first major shareholder class action was commenced in 1999,[5] shareholder class actions did not become a regular feature of the class action landscape in Australia until the mid-2000s. From about that time, there was talk of an 'avalanche' of shareholder class actions.[6]

9 While those predictions have not proved accurate, there has been a steady increase in shareholder class actions filings. Indeed, more shareholder class actions have been filed than any other type of class action and the rate of filings of shareholder class actions is increasing faster than all other types of class actions.[7]

Shareholder class action activity

10 Figure 1 shows the number of companies facing class action activity over the last 15 years. These numbers are to be distinguished from the number of class action filings (shown in Figure 2) which are significantly affected by the increasing trend for multiple class actions to be filed in relation to the same (or similar) conduct (as discussed further below).

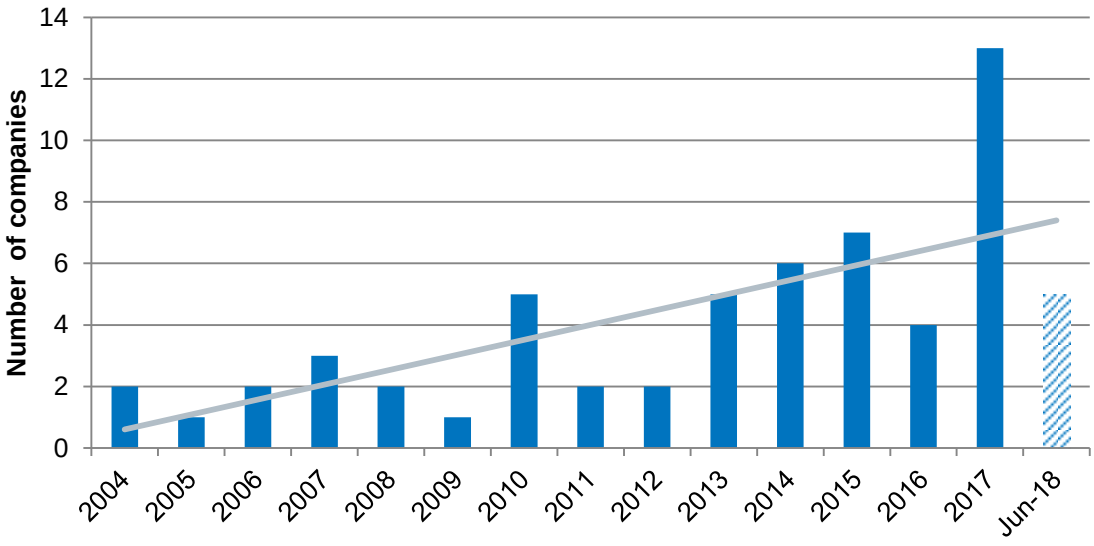

FIGURE 1: Shareholder class action activity since 2004 (multiple claims in relation to the same or similar conduct treated as a single claim)

[5] *King v AG Australia Holdings Ltd & Ors (formerly GIO Australia Holdings Ltd)* (Federal Court of Australia, Proceeding No. NSD955/1999).

[6] Justice Bernard Murphy, 'The Operation of the Australian Class Action Regime' (Speech delivered at the Changing face of practice - adapting to the new landscape conference hosted by the Bar Association of Queensland, Sheraton Mirage - Gold Coast, 8 – 10 March 2013) <http://www.fedcourt.gov.au/digital-law-library/judges-speeches/justice-murphy/murphy-j-20130309>.

[7] Allens 'Special Report: Class Action Risk 2016' (19 August 2016), https://www.allens.com.au/general/forms/pdf/ClassActionRisk2016.pdf; Allens '25 Years of Class Actions: Where are we up to and where are we headed' (25 March 2017), https://www.allens.com.au/pubs/class/papclass27mar17.htm.

11 Although the trend might be described as lumpy, there is a clear increase in activity over the last five years. In our observation, this trend is largely a result of the confluence of the following circumstances:

(a) an increasing number of law firms have focused on shareholder class actions as a significant business opportunity;[8]

(b) the active and growing third party funding market in Australia;

(c) increasing recognition of the plaintiff-friendly nature of the private rights of action arising from the continuous disclosure regime and the prohibition on misleading or deceptive conduct; and

(d) the introduction of, and amendment to, court procedures, rules and regimes designed to facilitate the bringing of class actions.[9]

Competing class actions

12 The increasing number of promoters involved in shareholder class actions has led to an increasing number of competing class actions against the same defendant in relation to the same or similar issues, often with overlapping class membership.

13 While this is not an entirely new development, the marked spike in the frequency of competing class actions is a recent phenomenon. Figure 2 shows the number of shareholder class action filings during the same 15 year period addressed by Figure 1. The charcoal sections represent those filings where more than one class action has been filed against the defendant in respect of the same or similar issues.

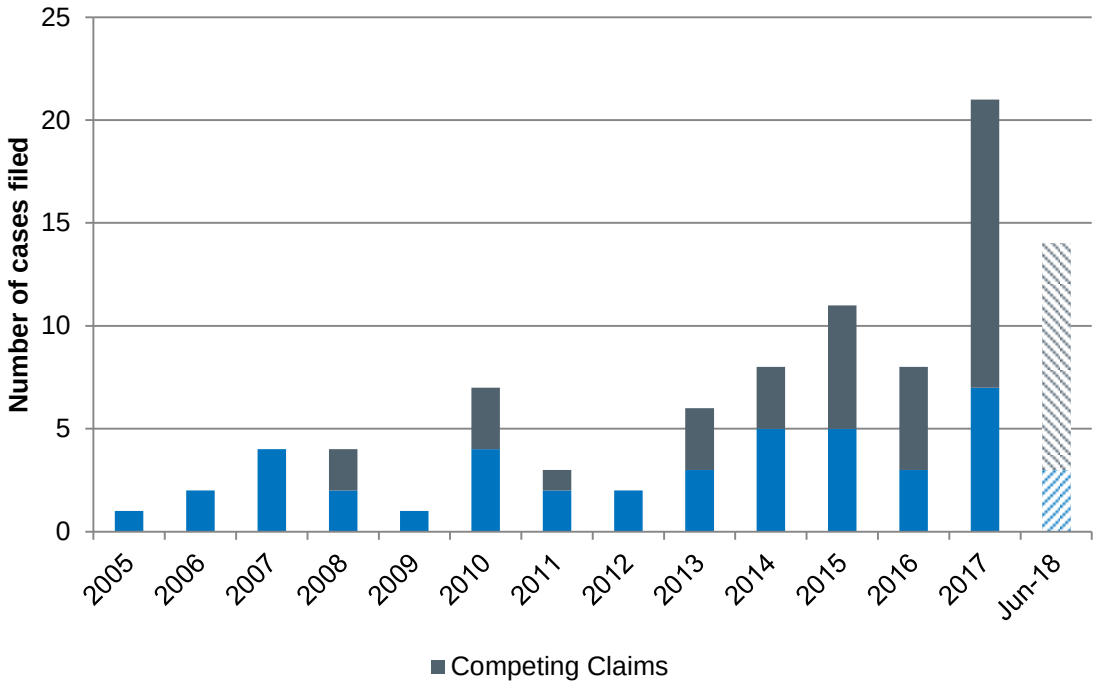

FIGURE 2: All shareholder class action filings since 2005, showing competing and non-competing claims

14 In our opinion, this trend is a troubling indicator of the increasing level of entrepreneurialism in the shareholder class action context. A trend which has been exemplified in recent months by the three

[8] Allens, 'Special Report: Class Action Risk 2016' (19 August 2016), *https://www.allens.com.au/pubs/class/papclass19aug16.htm.* Allens '25 Years of Class Actions: Where are we up to and where are we headed' (25 March 2017), https://www.allens.com.au/pubs/class/papclass27mar17.htm.

[9] The confluence of some of these factors is considered by Michael Legg in 'Shareholder class actions in Australia – the Perfect Storm?' (2008) 31 *UNSW L.J.* 669.

competing class actions against GetSwift and the five competing class actions against AMP. As we see it, perhaps more than anything else, this trend raises serious questions about the motivation for bringing these claims.

Third party funding of shareholder class actions

15 There is a strong connection between the acceptance and entrenchment of third party litigation funding in Australia and the development of the class actions landscape generally. That connection is, however, particularly strong when it comes to shareholder class actions. While less than half of all class actions are supported by third party funding,[10] almost all shareholder class actions are third party funded.

16 This difference cannot be explained by the costs of bringing shareholder class actions compared to other types of class actions. While shareholder class actions are significant undertakings which often require substantial expenditure on third party services (most notably expert evidence), they are not unique in that respect. Other types of class actions which have involved similar (if not higher) work levels and third party expenditures have been funded by plaintiff lawyers on a conditional fee basis.

17 In our opinion, the most likely reason for the anomalous rate of third party funding of shareholder class actions is the fact that shareholder class actions present a particularly attractive business proposition for funders for the following reasons:

(a) the size of the potential damages claim (which is a function of the number of allegedly 'damaged' shares and the alleged level of inflation per share) gives rise to the potential for significant settlements, and therefore significant funding commissions;

(b) the difficulties associated with defending the claims because of the nature of the relevant causes of action (as discussed further below); and

(c) the size of the potential exposure arising from an unsuccessful defence, which is the key driver for the 100% settlement rate (from defendants' perspective).

18 Indeed, the fact that every shareholder class action that has been resolved to date has been settled means that the prospects of a funder not recovering its outlay in a shareholder class action is perceived to be very low. The combination of these factors gives rise to a risk return ratio on shareholder class actions which cannot be matched by other types of class actions.

Shareholder class action defendants

19 It is most common for the listed company itself to be the only defendant in a shareholder class action. From time to time, directors and advisors (most frequently auditors) are also joined or, when the company is not a viable defendant, they may be the only defendants.

20 There is a slight trend in recent years towards the inclusion of additional defendants. While this is thought to bring additional complications to the prosecution of a shareholder class action, it also brings additional contributors to a potential settlement (and, particularly in the case of advisors, often additional insurance).

The role of the shareholders

21 Shareholders are represented by a representative plaintiff who brings the case on behalf of all other members of the class. Unlike in the United States, the Court is not involved in the process of selecting the representative plaintiff. Nor are there any particular requirements that the representative plaintiff must satisfy in relation to the number of shares or extent of alleged loss.

[10] Allens, 'Special Report: Class Action Risk 2016' (19 August 2016), *https://www.allens.com.au/pubs/class/papclass19aug16.htm*; see also Vince Morabito, 'An empirical study of Australia's class action regimes, Fourth Report: Facts and figures on twenty-four years of class actions in Australia' (Monash Business School, Department of Business Law and Taxation, August 2016), p.8.

22 As a result, in all but a handful of shareholder class actions filed to date, the representative plaintiff has been a retail shareholder with a relatively small financial interest in the case. This may be seen as counterintuitive given that, in most shareholder claims, institutional investors will have acquired a large proportion of the alleged 'damaged' shares and be entitled to the largest proportion of any compensation should the matter settle or be successful at trial.

23 There have been attempts by defendants to compel institutional investors to step forward as a representative of a sub-class on the basis that some elements of institutional investors' claims are likely to be significantly different to the nominated representative (ie a retail investor). Those attempts have, however, been rejected by the Court.[11]

Every finalised shareholder class action has settled

24 It is an extraordinary feature of the shareholder class actions environment that, despite more than eighty shareholder class actions being filed over a twenty year period, not one of those cases has proceeded to judgment.[12] As we see it, there are two core reasons which have motivated both plaintiffs and defendants to settle shareholder class actions in order to avoid a judgment.

25 From the plaintiff perspective, aside from the commercial benefits associated with receiving a sum certain at an earlier point in time, there is a generally recognised desire to settle in order to avoid the potential for an adverse decision on the question of how causation can be proved in shareholder class actions. The particular question is whether:

(a) it is necessary for each class member to prove actual reliance on the contravening conduct – often referred to as 'direct causation'; or

(b) the requirement can be satisfied by general notions of reliance by the market affecting the price at which each class member purchased and/or sold their shares – often referred to as 'market-based causation'.[13]

The answer to this question will determine whether causation can be treated as a common issue or whether each claimant must come forward individually to establish that the company's contravening conduct caused their loss (which would pose a very significant challenge for the commercial viability of shareholder class actions). While there have been two first-instance decisions supporting the availability of market-based causation,[14] it is generally accepted (including by lawyers whose cases rely on market-based causation) that the question will not be finally resolved until it is determined by the High Court.[15]

26 In our observation, the lawyers who have a repeat shareholder class action practice (on the plaintiff side) are reluctant to have the issue finally resolved because of the possibility that market-based causation could ultimately be rejected which would have a significant (if not fatal) effect on the economic viability of shareholder class actions.[16] This, in our observation, provides a strong motivation for plaintiffs to settle shareholder class actions.

27 From the defendant perspective, shareholder class actions often give rise to a very significant potential exposure because of the sheer number of allegedly 'damaged shares' (usually all shares

[11] For example, *Earglow Pty Ltd v Newcrest Mining Ltd* [2015] FCA 328.

[12] There are instances of shareholder claims being determined by judgment, most notably *Grant-Taylor v Babcock & Brown Ltd (In Liquidation)* [2015] FCA 149 and *In the matter of HIH Insurance Ltd (In Liquidation)* [2016] NSWSC 482, but neither of these proceedings was a class action.

[13] See Jenny Campbell and Jerome Entwisle 'The Australian Shareholder Class Action Experience: Are We Approaching A Tipping Point?' (2017) 36(2) *Civil Justice Quarterly* 177; Ross Drinnan and Jenny Campbell, "Causation in Securities Class Actions" (2009) 32(3) *UNSW L. J.* 928.

[14] *Re HIH Insurance Ltd (In liquidation)* [2016] NSWSC 482; *Grant-Taylor v Babcock & Brown Ltd (In liquidation)* [2015] FCA 149.

[15] In that respect we agree with the conclusion reached by Michael Legg and Madeleine Harkin, 'Judicial Recognition of Indirect Causation and Shareholder Class Actions' (2016) 44 *ABLR* 429, 434.

[16] It is notable that the first-instance decisions referred to above were obtained in cases pursued by a firm not generally considered as having a repeat class action practice.

acquired during the relevant period) and the alleged 'loss' said to be attached to each such share. In those circumstances, it is rational and responsible for defendants (and insurers) to look to eliminate that exposure at an appropriate level if the opportunity presents itself irrespective of the strength of its defence. Given the plaintiff camp's willingness to settle to avoid a decision on market-based causation and, in most cases, recognition that achieving a settlement will require a very significant compromise of the potential claim, that opportunity has presented itself in every case that has been resolved to date.

The standard approach to shareholder class actions

28 Central to any consideration of the efficacy of the shareholder class action environment is the 'standard approach' to the pursuit of shareholder class actions.[17] As the Commission described at 1.77, this invariably involves the following:

> Litigation funders and/or plaintiff law firms (or their hired experts) identify a significant drop in the value of securities. This is analysed to determine whether it is likely that the relevant drop had been occasioned by the late revelation of material information. Typically, the analysis determines whether or not it is likely that there is a sufficient basis for assuming the existence of contravening conduct during a period prior to the eventual announcement of the material information. The litigation funders and/or plaintiff law firms then determine the size of the potential loss that may have been occasioned by the suspected period of contravening conduct. The duration of that period may extend back for a considerable period, as in the recently announced class actions against AMP where a period of five years has been identified.

29 The key point to note here is that the genesis for most shareholder class actions is nothing more than an assumption that a drop in the share price in response to an announcement gives rise to a reasonable belief that there has been a breach of the company's continuous disclosure obligations (and/or misleading or deceptive conduct).

30 Assumptions of this kind (no matter how flimsy or well-founded) are the basis for most shareholder class actions and give rise to a level of risk that invariably leads to a settlement. This is not because every class action that is commenced is meritorious, but rather because of:

(a) the difficulties associated with defending the claims because of the nature of the relevant causes of action - which require immediate disclosure and do not require proof of intention to deceive, recklessness, negligence or indifference; and

(b) the size of the potential exposure arising from an unsuccessful defence, which often results in a willingness to settle even where a defendant considers that it has very strong prospects of successfully defending the claim.

As noted above, this creates a risk reward scenario that is extremely attractive to those interested in the commercial opportunities presented by the business of shareholder class actions.

Entrepreneurialism in shareholder class actions

31 The availability of these commercial opportunities means that, more than any other form of civil litigation, shareholder class actions tend to be driven by persons who are not the intended beneficiaries of the litigation – namely, lawyers and third party funders - referred to below for convenience (and non-pejoratively) as 'promoters'.

32 In our observation, the promoters are primarily responsible for determining which shareholder actions are pursued, how they are pursued, and when and for what amount they are settled. As we see it, this is a form of 'claims mining' which is primarily driven by profit making opportunities for the promoters rather than shareholders' pursuit of justice. Indeed, we do not see it as an

[17] See also the description of the architecture of a shareholder class action in Jenny Campbell and Jerome Entwisle 'The Australian Shareholder Class Action Experience: Are We Approaching A Tipping Point?' (2017) 36(2) *Civil Justice Quarterly* 177.

exaggeration or unduly alarmist to say that justice for shareholders has become little more than a convenient 'by-product' of shareholder class actions.

33 The development of this type of promoter-driven litigation (at least to the extent driven by lawyers) was observed by Justice Finkelstein in 2008 when dealing with two competing shareholder class actions brought against Centro:

> Putting the pleaded claims and classes to one side, there is something else that the actions have in common. Each is an example of a relatively new phenomenon in Australia, namely the lawyer-driven litigation. This is litigation where the lawyer investigates the potential for a claim and recruits the plaintiff and often the group on whose behalf a class action is initiated….
>
> There are many critics of entrepreneurial actions. There has been a long-standing concern about lawyers who solicit business and stir up litigation. In reality, though, solicitation is not improper per se, and it may be a good thing that lawyers find clients who would not otherwise have sought redress (or even realised that redress was available) for the wrongs that they have suffered. The acceptance of class actions has, I think, made that inevitable.[18]

34 If that phenomenon was relatively new in 2008, it is common place today. While shareholder class actions were once the domain of a small number of specialised plaintiff law firms, at last count there are at least 17 law firms who have filed one or more shareholder class actions in Australia. This broadening of the base has created significant additional capacity in the market to bring claims that would have previously been considered too speculative. It is also the primary driver for the growing incidence of competing shareholder class actions.

35 The funder-driven aspect is also crucial to this equation. Not only have funders underwritten the costs of almost every shareholder class action, they have also sought to change the fundamental nature of the shareholder class action in order to better serve their commercial objectives. Perhaps the most obvious examples of this are their success in establishing a right to bring 'closed class' class actions within the opt-out regime and their pursuit of common fund orders.

36 To be clear, our position is not that entrepreneurialism in shareholder class actions is problematic per se. As Justice Finkelstein noted in the Centro case, it likely results in shareholders obtaining some redress when they otherwise would obtain none. For us, the question is one of the balancing of interests and, in that respect, we are concerned that the balance has tipped too far in favour of the promoters of shareholder class actions at the expense of the shareholders – which, in turn, is having unintended consequences for listed companies and the operation of the continuous disclosure regime.

Unintended adverse consequences

37 It is generally accepted that:

(a) the shareholder class action environment has developed in ways that were not foreseen when the class action regime was enacted in 1992; and

(b) those that introduced the continuous disclosure and misleading or deceptive conduct laws did not foresee how those laws would be deployed by the promoters of shareholder class actions.

38 In those circumstances it is perhaps not surprising that, as the Commission noted 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

[18] *Kirby v Centro Properties Ltd* [2008] FCA 1505; (2008) 253 ALR 65 [4]–[5].

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.

39 We consider that the Commission's reference to 'unintended adverse consequences' arising from the confluence of the class actions framework and peculiar characteristics of the substantive law 'hits the nail on the head'. So too the Commission's identification of the following as the touchstones for considering whether reform is required:

(a) the propensity for companies to be the target of funded shareholder class actions;

(b) the value of the investments of shareholders at the time when that entity is the target of the class action; and

(c) the availability and cost of directors and officers liability cover within the Australian market.

We have addressed each of those touchstones below.

The propensity for companies to be the target of funded shareholder class actions

40 We have addressed the increasing likelihood of companies facing a shareholder class action and also the entrepreneurial spirit in which claims are mined in the paragraphs above. As noted above, these trends are not necessarily problematic per se - in our opinion, whether or not they are problematic needs to be considered by reference to whether they are serving the interests of the investment community.

41 As we see it, shareholder class actions do benefit the investment community in at least two important respects:

(a) First, thousands of shareholders have received payments in circumstances in which they would not have been able to do so through any other means. Given that every resolved case has settled, it is not possible to express a view as to what percentage experienced losses caused by genuine disclosure contraventions but it is not unreasonable to assume that at least some did.

(b) Second, the possibility of facing a class action has elevated the importance of listed companies complying with their disclosure obligations. For the most part, that is good thing. Although, as discussed further below, there are questions as to whether it has created an atmosphere of class action fear in some organisations that deflects focus from other (equally important) issues and potentially distorts disclosure decisions.

The mere existence of some benefit is not, however, a complete vindication of the shareholder class action environment. The benefits must be weighed against any adverse consequences.

42 We have addressed the diminution of shareholder investments and the effect on the D&O insurance market separately below in response to the specific issues raised by the Commission. Other legal and economic consequences arising from the current shareholder class action environment include the following:

(a) It is a feature of the market that 'bad news' or even potentially bad news can often result in a sell-off of a listed company's securities that is disproportionate to the actual financial impact on the entity. That overreaction is often corrected in the days following as investors process the information in more detail, or the listed entity releases information that provides more context, or analysts or media commentators provide a more balanced view to the market. The reality, however, is that a precipitous fall in the entity's security price can often be taken as an indicator of a legal failing to make appropriate and/or timely disclosure; whereas the reality is that the actual failing or event in question may ultimately be immaterial to the price (based on usual metrics for such an assessment). In such circumstances, a class action that galvanises around the initial price fall exposes the listed entity to a liability that may be of far greater consequence than if the broader market

dynamic was taken into account, particularly the exercise of self-executing stop-loss trading accounts. As we see it, the problem is that the principles underpinning class actions in a securities law context – being a mechanism for promoting timely and appropriate disclosure, incentivising compliance, deterring wrongdoing, and providing a remedy for shareholders harmed by inappropriate disclosure - are often undermined when the listed entity is confronted with a claim (or threat of a claim) when the quantum of damages bears no proportion to the materiality of the wrong committed.

(b) Our clients repeatedly tell us that continuous disclosure is a key focus for their boards which strive to do all that they can to ensure that their companies comply with their continuous disclosure obligations - both because of the imperative of complying with the company's legal obligations and also because of the related class action risk. Indeed, we get the sense that the angst around this issue is resulting in an over-focus on continuous disclosure issues which is tying boards in knots. We make the following observations in that respect:

(i) Particularly in the context of considering whether earnings guidance remains appropriate, a synthesisation of developing and uncertain information in relation to the performance of disparate parts of the business is often required, followed by a judgment call as to whether the earlier guidance is likely to be achieved while those matters are still very much in a state of flux. While it is easy to be critical of judgments made in this respect with the benefit of hindsight, it should not be assumed that decisions such as this are not made with a very high level of diligence (and angst) in the moment. Unlike the way in which a regulator may review this decision making process, the shareholder class action model does not allow for a fair and balanced consideration of the judgment call made in the moment. On the contrary the price-driven model assumes – with the benefit of hindsight – that the wrong decision was made.

(ii) Moreover, those decisions are often also made with acute awareness that making a market disclosure 'just in case' the guidance is not achieved, may inappropriately reduce shareholder value which may in itself result in a shareholder class action. This additional layer of complication, and potential exposure, adds further complexity and pressure to the board's decision making process and wards against 'just in case' disclosures.

(iii) That said, on some occasions, the acute awareness of class action risk may result in over-disclosure. This may not be seen as problematic – indeed, some class action promoters have long said the more disclosure is always better. However, in circumstances in which investors are entitled to assume that the fact of disclosure signifies materiality, over-disclosures have the potential to create an uninformed (or misinformed) market.

(iv) As an aside, it is also well understood that class action risk has significantly curtailed the extent to which many companies are prepared to provide future earnings guidance – a practice which significantly impedes the ability of analysts to perform valuations and, consequently, for investors to gain a meaningful insight into the company's prospects.

(c) In at least some cases, this over-concentration of focus and time on continuous disclosure issues is at the expense of consideration of other risks and also at the expense of pursuing the profit-making objectives of the company for the benefit of shareholders.

(d) Moreover, a company that faces a class action (whether meritorious or not) will be required to divert significant resources and attention to the class action to the likely detriment of the pursuit of shareholder value through operational activities.

(e) As mentioned above, companies often settle shareholder class actions because a settlement which eliminates its exposure and allows it to 'move on' is considered in the interests of the company when compared to the size of the potential exposure associated with an adverse judgment – this is usually the case irrespective of the strength of its defence. In these circumstances, simply being the target of a shareholder class action (irrespective of its merits) is likely to result in a significant outflow of funds from the company to class action promoters. While some of this amount may be covered by insurance, it is rare for insurance to cover the full amount.

43 These unintended consequences affect both the interests of the company itself and also the market more generally. When considering the effect on the market, it is also relevant to consider the role shareholder class actions are said to play as a form of private regulation. Leaving aside the policy questions associated with this role being undertaken by commercial enterprise, in our opinion there are very significant questions as to the effectiveness of shareholder class actions as a form of private regulation for at least the following reasons:

(a) Logic would suggest that the increasing rate of shareholder class action filings indicates increasing non-compliance with continuous disclosure obligations. This is, however, clearly not the case – as noted above, in recent years there has been increasing focus on the imperative of complying with continuous disclosure obligations because of class action risk. While it might be expected that companies will get it wrong from time to time, it is not plausible that there would be an increase in non-compliance with the very obligations companies are overly-focussed on complying with. This suggests that shareholder class actions are not having the deterrent effect to be expected of effective private regulation – rather, as discussed above, they are having a different effect altogether which is not necessarily aligned with the objectives of the continuous disclosure regime.

(b) ASIC ordinarily brings enforcement proceedings where there has been a degree of culpability in an alleged failure to disclose. As discussed above, the standard shareholder class action model has no regard to the level of culpability. For example, claims relating to profit downgrades do not allege that a company reached a view as to the deterioration of future earnings expectations and chose to conceal it. Rather they tend to claim, with the benefit of hindsight, that the company ought reasonably to have reached a particular view earlier than it in fact did.

(c) As noted above, every resolved shareholder class action has settled. This means they do not bring the clarity to the law that a judgment or regulatory process could be expected to deliver.

The value of the investments of shareholders

44 When considering the value of an individual shareholder's investment, the fact that shareholder class actions involve shareholders suing themselves is front and centre.[19] Although an undiversified shareholder may benefit from a compensation payment, diversified shareholders are likely to be both winners and losers from shareholder class actions across their portfolio over time. Importantly, however, that redistribution comes at a cost. At its most obvious, there is significant 'leakage' from the pool of total shareholder wealth in the form of legal and funding fees; and the diversion of management focus and resources away from the profit-making enterprises of

[19] See Paul Miller, 'Shareholder class actions: Are they good for shareholders?' (2012) 86 A.L.J. 633. This issue is also identified in Michael Legg, 'Shareholder Class Actions in Australia – the Perfect Storm?' (2008) 31(3) *UNSW L.J.* 669, 709.

the company hinders growth in overall shareholder wealth. Particularly in circumstances in which class action settlements are rarely (if ever) fully covered by insurance, those transaction costs are a significant impost on the Australian equity pool.

45 It may be suggested that the fact that shareholders are choosing to participate in shareholder class actions is evidence that market participants do not consider those costs to outweigh the benefits. That is not, however, necessarily the case. Anecdotally, the prevailing view appears to be that, if there is going to be a class action in any case, it is in the interests of any individual shareholder to join (and some institutional investors consider that they have a fiduciary obligation to join). So far as we are aware, there has never been any broader consideration by the investment community as a whole as to whether shareholder class actions are in the best collective interests of shareholders.

46 Aside from the significant transaction costs, there are other ways in which shareholder class actions undermine shareholder value, including the following:

(a) to the extent not covered by insurance, the amounts paid to defend and settle shareholder class actions represent a significant drain on funds available for distribution to shareholders and/or to invest in wealth generating projects;

(b) as noted above, defending a class action diverts management's attention away from pursuit of wealth generating projects;

(c) announcement that a shareholder class action has been filed, or even that a class action is under consideration, may cause the company's share price to fall – importantly, announcements that a class action is under investigation are often made shortly after a corrective disclosure and before any considered analysis of the antecedent circumstances; and

(d) as discussed further below, the increased cost of insurance resulting from growing class action risk is ultimately borne by all shareholders.

Directors' and officers' insurance

47 The Commission has referred to the increasing cost of directors' and officers' insurance and the withdrawal of certain insurance providers as a result of the increasing incidence of shareholder class actions.

48 While this is an issue that can best be addressed by the insurance industry, the Commission's observations are consistent with our experience. As we see it, the consequences of the observed phenomena include the following:

(a) Reduced availability of entity cover will further increase the stakes for the company and therefore arguably exacerbate the consequences of the over-focus on class action risk discussed above, and also increase the stakes (and potential diminution of shareholder wealth) for a company faced with a shareholder class action.

(b) If entity cover is phased out or further limited:

(i) it increases the prospects that directors will be named in shareholder class actions in an attempt to bring the D&O policy into play. Any such development can reasonably be expected to affect the ability of companies to attract appropriately qualified and experienced board members; and

(ii) it is also likely to increase the prospects that third party advisors (such as auditors) will be joined to shareholder class actions, which can be expected to increase the costs of those services.

(c) The increased cost of D&O insurance is, of course, also a further drain on shareholder wealth.

A review is both required and timely

49 Having regard to:

(a) the breadth and seriousness of the unintended adverse consequences arising from shareholder class actions; and

(b) the questions raised above (and elsewhere in our submission) in relation to whether, in this increasingly entrepreneurial environment, shareholder class actions are appropriately being pursued for the benefit of shareholders,

we consider that the Commission's proposal (for a review) is both timely and well-founded.

50 To repeat the observation made in the introduction to this chapter, it is difficult to see how, after almost twenty years of shareholder class action experience, it could be suggested that these issues are not of sufficient importance to the conduct of business in this country to warrant an informed and balanced review of whether the continuous disclosure regime, and the private right of action arising from a possible breach, are serving the interests of shareholders and the broader business community.

Potential areas for reform

51 An in-depth consideration of the potential areas for reform is beyond the scope of the issues raised by the Commission. We would welcome the opportunity to contribute to the debate on potential reforms at an appropriate time. For now, we have limited our comments on this issue to some high level thoughts on potential areas for reform.

52 In our opinion, the area most ripe for reform is the fact that a private right of action currently arises without need to establish (or even allege) any form of intention, fault, negligence or indifference on the part of the company. We consider that it would better align with the objectives of the regime and serve the interests of the investing public if a private right of action was limited to circumstances in which there is a degree of management fault or culpability. This could be achieved through either of the following means:

(a) Amending the Corporations Act to provide for a private right of action only where there is a degree of intentional concealment, recklessness or negligence in the alleged non-disclosure or misleading disclosure. Although obviously increasing the burden on those bringing a class action, such a requirement would still be significantly less onerous than the 'scienter' requirement in equivalent class actions in the United States (which requires proof of an intent to deceive, manipulate or defraud to ground a private right of action).[20] It would also be less onerous than United Kingdom law which requires *dishonest* omission or delay.[21]

(b) Introducing defences for the company similar to those available to individuals alleged to have been 'involved' in a contravention. For example, this might include defences of due diligence, reasonable and honest belief or reliance on professional advisers. This would be broadly analogous to the defences available to companies under UK law.[22] It would also be

[20] *Securities Exchange Act 1934* (US) s 10(b).
[21] *Financial Services and Markets Act 2000* (UK) s 90A.
[22] *Financial Services and Markets Act 2000* (UK) s 90 and Schedule 10 and Corporations Act s674(2B).

conceptually consistent with defences for other disclosure obligations contained in the Corporations Act, such as:

(i) the 'due diligence defence' and 'reasonable steps defence' in sections 731 and 1021E(4), respectively, for misleading and deceptive statements included in prospectuses and product disclosure statements; and

(ii) section 1308(4) which provides for liability where a person has made or authorised the making of a statement or omits or authorises the omission of any matter, which makes the relevant document materially misleading, *without having taken reasonable steps* to ensure the document was not false or misleading, or to ensure the statement did not omit any matter which made the document misleading.

53 Consideration could also be given to other amendments to the private right of action with a view to limiting that right to those shareholders who have truly suffered loss by reason of the alleged conduct, including through the following means:

(a) Expressly limiting an entitlement to damages to shareholders who prove that they relied upon the alleged conduct in making their investment decision. This would involve rejecting the market-based causation discussed above.

(b) Capping damages in circumstances in which the share price rebounds quickly after the relevant price decline in an attempt to limit damages to losses caused by the contravention rather than unrelated market conditions. This was one of a suite of measures introduced into United States law by the *Private Securities Law Reform Act 1995* in an attempt to curb a perceived increase in the number of speculative shareholder class actions. The 'bounce back' provision in the PSLRA caps damages at the difference between the price paid for the share and the average price during the 90-day period following the corrective disclosure.

54 While, generally speaking, we do not consider that is necessary to amend the disclosure obligations themselves, which are the subject of regular review and are well understood in the business and investment communities, sensible reforms that could be considered include the following:

(a) Relaxing the requirement that information be disclosed 'immediately' in favour of, for example, a requirement to disclose 'as soon as practicable' or 'promptly'[23] in recognition of the fact that it ordinarily takes time for information to find its way to decision makers with the requisite level of accuracy and for an assessment to be made as to its materiality.

(b) Providing further guidance in relation to the test for materiality (that is, the information would, or would be likely to, *influence* persons who commonly invest). This could include, for example, formalising the percentage by which a matter will either be deemed material or not material, having regard to commonly accepted baselines by economists and the ASX (for example, less than 5% is not generally regarded as material).

(c) Reviewing the proper intent and operation of the definition of 'aware' in ASX Listing Rule 19.12 to make it clear that it is does not extend to constructive knowledge (which can cover information which is not actually known by key decision makers within the entity).

[23] As suggested in a letter from Law Council of Australia to ASX Limited dated 16 December 2011: http://lca.lawcouncil.asn.au/lawcouncil/images/LCA-PDF/docs-2400-2499/2495%20Continuous%20Disclosure.pdf.

Chapters 3, 4 and 5: Litigation funders, conflicts of interest, legal and funding fees

1 In Chapters 3, 4 and 5, the Commission addresses the issues of regulating litigation funders, conflicts of interest, funding commission rates and legal fees. As we see it, these issues are tightly interconnected as they all go to the complex and fundamental nature of how class actions are conceived, run and resolved, and how those involved in that process (on the plaintiff side) are remunerated.

2 The promotion of class actions has become an increasingly entrepreneurial endeavour over the course of the last decade. As discussed in our introduction, entrepreneurialism is not in itself problematic – indeed, it is well accepted that it creates opportunities for claimants to enforce their legal rights in circumstances that would not otherwise be possible. It is, however, critical to ensure that the forces of entrepreneurialism remain in check and continue to serve the objectives of the class action regime. Absent those checks, there is a real risk that those forces will undermine the credibility and integrity of the class actions regime.

3 From the 'behind the scenes' vantage point we have in acting for defendants in a broad range of class actions, we have become increasingly concerned that the entrepreneurial forces are developing in a way that is resulting in an increasing number of instances of conduct that appears to prioritise the interests of the lawyers and/or funders over the interests of group members.

4 While group members may still be better off because a claim has been brought on their behalf and may receive an 'acceptable' return, the prioritisation of lawyer and/or funder interests is detrimental to both group members and defendants. As we see it, much of this conduct is driven by the fact that funders (and not group members) are the potential repeat clients of the lawyers.

5 Examples of such conduct in the public domain include the following:

(a) the first common fund application in the Allco shareholder class action, which was described by Justice Wigney as potentially in the interests of no-one other than the funder;[24]

(b) the common fund application in the QBE shareholder class action, in which the Full Court modified the proposal put to it on behalf of plaintiff to ensure that no group member would be worse off as a result of the arrangements;[25]

(c) in the context of the settlement approval processes in the Newcrest shareholder class action, the solicitors for the plaintiff submitted that the Court did not have the right to consider whether the contractual funding arrangements in that case were fair to group members; [26] and

(d) in the context of the settlement of the Banksia class action, the funder argued that group members were prohibited by the terms of funding agreement from appealing the settlement approval orders.[27]

6 Each of these is an example of what, from our perspective, appears to be the commercial interests of the funder being advanced over the interests of the group members. It is also important to recognise that, in each of these examples, the Court recognised the problem and took steps to address it – however, not all conduct of this kind comes to the attention of the Court.

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[24] *Blairgowrie Trading Ltd v Allco Finance Group Ltd (Recs & Mgrs Apptd) (in Liq)* (2015) 325 ALR 539 [168]-[185].

[25] *Money Max Int Pty Ltd v QBE Insurance Group Ltd* (2016) 245 FCR 191 [9]-[14] and Annexure A.

[26] *Earglow Pty Ltd v Newcrest Mining Ltd* [2016] FCA 1433 [126], [148]-[158].

[27] *Australian Funding Partners Limited v Botsman* [2018] VSC 303 [4]. See also a summary of this decision on Supreme Court of Victoria website <https://www.supremecourt.vic.gov.au/law-and-practice/judgments-and-sentences/judgment-summaries/australian-funding-partners-limited-v>.

7 Other more subtle forms of conflicts are referred to at 4.9 and 4.10 of the Discussion Paper. Moreover, in addition to conflicts between the group members and promoters, there are also many instances of conflict between the interests of different subsets of group members (the so called 'duty - duty' conflict).

8 Against that background, we welcome the Commission's willingness to recognise and attempt to grapple with these issues and also to propose some practical solutions. We recognise that the objective of this exercise should not be to stifle entrepreneurialism, but rather to ensure that entrepreneurial forces are supporting the objectives of the class action regime having regard to the interests of each of its intended beneficiaries – potential group members, defendants and the judicial system.

9 The importance of keeping entrepreneurial forces in check in the class actions context was recognised by the Chief Justice of the Federal Court in a 2016 speech when he said:

> If commercial interests and commercial returns (as opposed to professional responsibilities) are seen to drive a substantial section of this work then the cost of defending claims and the public cost of providing the infrastructure for them will come to be seen as an impost on Australian business and public infrastructure that will not be seen as acceptable.[28]

10 In that speech, the Chief Justice also emphasised the fiduciary obligations of lawyers and the imperative of every decision being made in the interests of the litigants:

> Central to the successful working of the system and the reality and perception of the social utility of class actions is the recognition of what the process is or should be: the vindication of just claims, and their resolution through a process characterised by parties (applicants and respondents) that recognise the critical features of ss 37M and 37N and a profession that not only recognises its responsibility in those provisions, but also the strict fiduciary capacity in which it works, such that every decision concerning the litigation and its running can be seen as taken in the interests of the litigants.[29] [emphasis added]

11 Against that background, we have addressed some of the specific recommendations raised by the Commission in relation to the regulation of litigation funders, conflicts of interest, legal fees and funding commissions below.

CHAPTER 3: REGULATION OF LITIGATION FUNDERS

12 Chapter 3 of the Discussion Paper addresses the need for additional regulation of third party litigation funders. We agree with the Commission that the current arrangements to manage and counter the risks inherent in funded class actions are inadequate considering the increasing prevalence of litigation funding, the types of litigation funders entering the Australian market and the conduct described above.

13 In particular, we support the Commission's recommendation that a bespoke licensing regime be introduced for the litigation funding industry. We support modelling that regime on the Australian Financial Services Licence (**AFSL**) scheme, supplemented by specific requirements as to capital adequacy and conflict management. We also agree that it is necessary that licensees be subject to regular auditing to ensure that the regime is not a 'dead letter'.

Licensing of litigation funders is necessary

14 We agree with Commission's recommendation that the Corporations Act should be amended to require third party litigation funders to obtain and maintain a 'litigation funding licence' to operate in Australia.

[28] Justice James Allsop, *Class Actions* (speech at Law Council of Australia Forum, 13 October 2016).
[29] Ibid.

15 The current lack of regulation of litigation funders has attracted a number of funders with untested financial backing and credentials into the Australian market. The case involving Argentum Capital, cited at 3.25 of the Discussion Paper, is perhaps the most well-known as it involved the funding of a class action against the Commonwealth of Australia by an alleged Ponzi scheme incorporated in the tax haven of Jersey.[30] We are, however, also seeing an increasing number of new local and offshore funders with undisclosed financial backing or skills entering the Australian funding market.

16 As the Commission observes, the introduction of a licensing scheme is unlikely to undermine competition in the market or increase funding commission rates. As addressed elsewhere in the Discussion Paper, the Court is playing an increasingly important role in ensuring that commission rates are reasonable and do not impose an unreasonable impost on group member returns. Moreover, in our opinion, the types of funders that would have difficulty complying with the proposed licensing regime are not those offering the most competitive rates. The exclusion of those funders from the market is therefore unlikely to materially reduce competitive pressures on commission rates.

The licensing regime should be bespoke, but modelled on the AFSL regime

17 We support the Commission's proposal for a bespoke litigation funding licensing regime rather than requiring litigation funders to hold an AFSL. Not only is litigation funding a unique category of financial product, but the relationship between the litigation funder and group members is different to the relationships between other financial institutions and their clients. This is particularly the case in class actions in which the Court makes a common fund order – in that, in those cases, there may be no interaction between group members and the funder providing financial services to them.

18 That said, we support Proposal 3-2 that the basic licence terms should be modelled on those applicable to AFSL holders and require litigation funders to:

(a) do all things necessary to ensure that their services are provided efficiently, honestly and fairly;

(b) ensure all communications with group members and potential group members are clear, honest and accurate;

(c) have adequate arrangements for managing conflicts of interest;

(d) have sufficient resources (including financial, technological and human resources);

(e) have adequate risk management systems;

(f) have a dispute resolution system for complaints; and

(g) be audited annually.

Duty of good faith

19 In our view, the licensing regime should also impose on litigation funders a duty of good faith towards funded group members (including group members subject to a common fund order) akin to the duty owed by insurers, both under common law and by virtue of section 13 of the *Insurance Contracts Act 1984* (Cth). This duty would require that, where funders exercise any contractual (or court-approved) rights to make decisions as to the conduct of class action litigation, including in the context of settlement, they would need to act in good faith with regard to the interests of group members.

[30] Sydney Morning Herald, *Ponzi scheme claims against litigation funder of equine class action* (22 February 2014) Sydney Morning Herald <https://www.smh.com.au/business/ponzi-scheme-claims-against-litigation-funder-of-equine-class-action-20140221-337my.html>.

20 In the event of a breach of this duty, ASIC should be empowered to address the breach, in a manner similar to that provided for under the AFSL scheme, by:

(a) initiating or continuing representative action against the funder;

(b) issuing a banning order, suspension or cancellation of the licence; or

(c) imposing further conditions on the licence upon acceptance of an enforceable undertaking by the funder to not act in a particular manner.[31]

Applicable financial standards

21 We agree with the Commission that any licencing regime must impose minimum prudential standards. This ensures both plaintiffs and defendants are protected from impecunious litigation funders who may facilitate the commencement of a class action but may be unable to meet their obligations under the litigation funding agreement (or common fund orders). As noted by the Productivity Commission, capital adequacy requirements are a way of legitimising the litigation funding industry by ensuring only 'reputable and capable' funders enter the market.[32]

22 Under the current AFSL regime, ASIC Regulatory Guide 166 provides guidance as to appropriate financial requirements for responsible entities to hold a licence. Those financial requirements include:

(a) access to enough financial resources to meet liabilities for at least the next 12 months;

(b) the licensee must hold minimum net tangible assets of the greater of $10 million or 10% of its average revenue;

(c) base level financial requirements (solvency and positive net asset requirement; case needs requirement and audit requirement);

(d) surplus liquid funds and adjusted surplus liquid funds where applicable; and

(e) tailored and/ or additional financial requirements reflecting particular financial products and services offered.

We are not best placed to comment as to whether these are the appropriate standards for litigation funders but agree with the Commission that the AFSL requirements should be the starting point.

23 Moreover, in our opinion, as is the case in the insurance industry, appropriate prudential standards for funders are likely to require actuarial input on an individual basis by reference to the funder's case portfolio. Such an analysis should take account of the funder's contingent liabilities, including the costs of running the proceedings it is funding, any orders for security of costs in those proceedings and potential liability for adverse costs orders.

24 We also support the Commission's view that the availability of security for costs does not negate the need for prudential standards. Security rarely covers all of a defendant's costs and does not protect a defendant from spending time and incurring expenses for a claim that may not ultimately proceed due to an impecunious funder.

Other standards

25 We support the Commission's suggestion that the licensing regime should (at the very least) impose character standards equivalent to those required for the holders of AFSLs. This includes:

(a) good fame and character requirements (for corporate funders to be assessed by reference to the character of the responsible managers); and

[31] ASIC has these powers in relation to insurance contracts pursuant to section 14A of the *Insurance Contracts Act 1984* (Cth).
[32] Productivity Commission, *Access to Justice Arrangements*, Inquiry Report No 72 (2014) Vol 2, 632.

(b) minimum standards as to organisational competence.

26 That said, we do not think that it is necessary that litigation funders be required to have relevant legal skills in civil litigation. Although many litigation funders are staffed by experienced lawyers or former lawyers, the role of the funder is to financially support the proceedings and should not be to conduct or guide the litigation. Indeed, requiring funders to have legal skills may be seen to provide legitimacy to funders having a more substantive role in the conduct of the proceedings than is appropriate having regard to the paramountcy of the interests of group members.

Licensing regime should apply to foreign funders

27 The Commission notes that many overseas funders would be unwilling to bring capital to Australia to satisfy any new licence requirements. To address this issue it suggests that, similar to the current AFSL regime,[33] litigation funders that are subject to foreign regulatory requirements comparable to Australian requirements may apply for exemption from the proposed litigation funding licensing regime.

28 We are strongly of the view that no such exemption should be available for overseas funders for the following reasons:

(a) First, having regard to the nature of litigation funding and, in particular, the obligations assumed by litigation funders, it is not sufficient for funders to be subject only to offshore regulation. In this respect we note that, after the Commission published its Discussion Paper, ASIC announced that the exemption approach under the AFSL regime is under review. ASIC's 'Foreign financial services providers consultation paper 301' recommends that, from 30 September 2019, the exemption should be abandoned in favour of foreign Australian financial services licensing. The key reasons provided in the paper for this change include:

(i) relief by exemption may no longer strike the appropriate balance between cross-border investment facilitation, market integrity and investor protection as originally envisaged;

(ii) introduction of a foreign licence would allow a fuller range of supervisory and enforcement tools to address misconduct by foreign entities and effectively monitor and supervise their conduct in Australia;

(iii) a licensing scheme is consistent with regulatory approaches of ASIC's major peer regulators for equivalent types of financial services providers; and

(iv) a foreign licence would be consistent with licensing processes for ordinary AFSL holders.

We consider that these considerations apply equally to foreign based litigation funders operating within Australia.

(b) Second, we are not aware of any comparable regulation of litigation funders in other jurisdictions. The only jurisdiction we are aware of that has a bespoke form of litigation funding licensing regime is Singapore,[34] and the level of regulation imposed by the Singaporean legislation is not comparable to the Commission's proposed regime.

29 In light of these issues, we consider that an appropriate response is to require foreign litigation funders to be licenced in Australia and to meet capital adequacy requirements by holding cash or cash equivalents with an Australian authorised deposit taking institution.

[33] *Corporations Act 2001* (Cth) s 911A(2)(h).
[34] *Civil Law (Amendment) Act 2017.*

30 We think that it is also appropriate that the licensing regime require foreign litigation funders to have a director or responsible manager resident in Australia. We consider this to be an appropriate and convenient measure, particularly given that certain orders (particularly common fund orders) require litigation funders to provide an undertaking to the Court.

Australian Financial Complaints Authority

31 In response to Question 3-3, we think that third party litigation funders should be required to join the Australian Financial Complaints Authority scheme. If the licence is modelled on the AFSL, then AFCA is the appropriate complaints body for disputes between group members and litigation funders, other than disputes that relate to the conduct of the proceedings that are more likely to be appropriately addressed by the Court.

Other possible regulation outside of the licensing regime

32 In addition to the regulation proposed by the Commission, there are two other reforms that could be considered to appropriately regulate litigation funders.

33 First, the Commission could consider recommending that section 37N of the Federal Court Act be amended to require third party litigation funders to act in a way that is consistent with the overarching purpose in section 37M. This approach has been adopted in section 11 of the *Civil Procedure Act 2010* (Vic), which gives the Supreme Court of Victoria additional express powers to regulate the conduct of third party litigation funders involved in civil proceedings.

34 Second, the Commission could consider recommending that section 43(3) of the Federal Court Act be amended to expressly give the Court the power to order costs against third party litigation funders. This may be appropriate, for example, where a litigation funder has acted contrary to the overarching purpose by causing a representative plaintiff to bring an unmeritorious application or otherwise intervened in a way that has occasioned additional costs to the plaintiff or the defendant.

CHAPTER 4: CONFLICTS OF INTEREST

35 Chapter 4 of the Discussion Paper specifically addresses conflicts of interest between representative plaintiffs, group members, lawyers for the representative plaintiff and third party litigation funders. For the reasons discussed in our introductory remarks to this section, we consider the conflicts that arise in this context to be both significant and pervading, and the most challenging issue in preserving the integrity of the class action regime.

36 Accordingly, we support the Commission's overall objective of seeking to address these conflicts by:

(a) better regulating third party litigation funders (as discussed above) and the solicitors who bring class actions; and

(b) clearly delineating the respective roles, and corresponding duties, of lawyers and third party funders in class action proceedings.

37 However, the Commission's proposals that seek to specifically address conflict issues stop short of what would be required to truly get to the core of the issue. This is because those proposals only seek to address the threshold issue of direct conflict (for example, by avoiding direct financial relationships between lawyers and third party funders in the same proceeding). In our opinion, to truly address these issues it would be necessary to also address more indirect sources of conflict that arise from the commercial drivers that influence the bringing and running of class actions – the issue that looms largest for us in that respect is the dynamic created by the third party funder being the more likely 'repeat client' of the lawyer. In our view, this more searching assessment is

not capable of being addressed solely by external regulation (or notions of 'informed consent'), but rather requires proactive management by the Court on a case-by-case basis.

38 We have set out below our response to each of the Commission's proposals and questions from Chapter 4, and elaborated on why we think the Court is best placed to actively manage conflicts of interest in the proceedings brought before it.

Regulation of funders (absent a licencing regime)

39 Proposal 4-1 is that, if a funding licencing regime is not adopted, third party litigation funders should remain subject to ASIC Regulatory Guide 248 in relation to managing conflicts of interest.

40 As noted above, we strongly support the introduction of a bespoke licensing regime. Fundamental to this position is our view that Regulatory Guide 248 has been ineffective in regulating the behaviour of litigation funders. Indeed, we are not aware of any action taken by ASIC to enforce the obligations, a point similarly identified in the VLRC's report on Litigation Funding and Group Proceedings. According to the VLRC, this lack of enforcement has 'contributed to the concern that there is no effective oversight of industry practices or prevention of unethical conduct'.[35]

41 If, however, a licensing regime is not to be adopted, then we agree that funders should remain subject to ASIC supervision through Regulatory Guide 248. We also agree with the Commission that, at the very least, funders must be required to report annually to ASIC on their compliance with Regulatory Guide 248.

42 We expect that one reason for the lack of ASIC enforcement activity since Regulatory Guide 248 was introduced is a lack of readily available information about compliance – to some extent, this may be addressed by mandatory annual reporting. Another reason may be the difficulty in satisfying a criminal burden of proof and the low associated penalty. The current maximum penalty of ($10,500) for failing to implement adequate practices for managing conflicts of interest is insufficient and unlikely to encourage compliance.

43 Finally, we agree with Proposal 4-2 that 'law firm financing' or 'portfolio funding' should be captured as a 'litigation scheme' in the Corporations Regulations to ensure these funding arrangements are subject to proper conflict of interests management. That said, there may be practical difficulties 'shoehorning' these arrangements into the current regulatory regime as they would not necessarily meet the current definition of 'managed investment scheme', and therefore regulation by way of exemption under sub-regulation 7.6.01AB of the Corporations Regulations may not be appropriate. These challenges are another reason to prefer a full licensing regime rather than simply trying to tinker with the current arrangements.

Regulation of solicitors

44 We agree with the Commission's observation that class actions give rise to unique conflict issues for solicitors acting for the representative plaintiff. We do not, however, see specialist accreditation as being a solution to these issues.

45 As discussed at 4.12 of the Discussion Paper, third party funders often retain (or have a role in choosing) the solicitors to represent group members and a funder's presence in the proceeding can give rise to a risk of decisions being made that are adverse to the group members but are preferable to the funder. The reality is that the funder is the 'repeat client' of the lawyers – not the representative plaintiff – making preservation of the relationship with the funder important for the lawyer. As we see it, this gives rise to the real risk (or at least temptation) that the interests of the funder will be preferred over the interests of the plaintiff and other group members.

[35] Victorian Law Reform Commission, *Access to Justice: Litigation Funding and Group Proceedings*, Report (2018) [2.113].

46 Lawyers acting for representative plaintiffs also face the unique conflict scenario of having to manage the relationship between the representative plaintiff and the balance of the group members. The interests of the plaintiff and the group members will not always align, and the conflict between those interests can become acute when it comes to negotiating a settlement of the proceeding.

47 The Commission's primary proposal to address the conflict position of solicitors is the introduction of specialist accreditation in class action law and practice (Proposal 4-3). Although we appreciate the intent behind the accreditation proposal, and generally agree that there is a need to ensure 'new entrants' properly understand the need to manage the unique conflicts and obligations that arise in the representative context, we do not think that accreditation is the answer to the broader conflict issues. This is for a number of reasons, including the following:

(a) First, accreditation will only work if it changes the behaviour of those engaging solicitors, so that only accredited firms are engaged to run class action. Outside of the context of competing actions (where the Court may play a role in this selection process), it is not clear to us that significant weight will be put on whether or not the proposed solicitor firm holds accreditation. The fact is that, in this environment of promoter-driven class actions, representative plaintiffs or group members will rarely (if ever) be involved in the selection of the lawyers. Where the person making the decision is the litigation funder, they are more likely to consider their experience with the firm and the outcomes of the proceedings the firm has previously been involved in.

(b) Second, accreditation really only deals with the threshold issue of training solicitors to identify actual or perceived conflicts. Some conflicts cannot be avoided and the real issue is making sure those conflicts do not result in steps being taken that are adverse to the plaintiff's interests, the interests of group members or, more fundamentally, the interests of justice. Legal education is unlikely to be sufficient to address this issue.

48 As an aside, we also question whether the Law Council of Australia (which is not an accrediting body) is the appropriate body to administer any such accreditation program.

Solicitors having interests in litigation funders

49 As will be evident from our comments above, we support Proposal 4-4 that the Australian Solicitors' Conduct Rules be amended to prohibit solicitors and law firms from having financial and other interests in a third party litigation funder that is funding the same matter in which the solicitor or law firm is acting.

50 As recognised by the Supreme Court of Victoria in *Bolitho v Banksia Securities Limited*, where the solicitor has a financial stake in the funder (who is funding the litigation that the solicitor is running), there is a much greater risk the solicitor will not bring, or be seen to bring, the necessary objectivity that the solicitor's role demands.[36]

51 However, we consider that the prohibition should be extended to other arrangements which do not necessarily amount to a pecuniary or other interest in the litigation funder, but which nonetheless may give rise to the likelihood that plaintiff or group member interests may be de-prioritised over the interests of the funder. This may include arrangements that do not involve a direct financial interest but instead involve reciprocal commercial arrangements.

Informed consent is not sufficient

52 Proposal 4-6 is that potential conflicts should be better managed by means of obtaining the group members' informed consent. Specifically, it is proposed that a notice be sent to the class at the earliest opportunity (likely with opt-out notices) informing the class of any conflicts of interest.

[36] *Bolitho v Banksia Securities Limited* [2014] VSC 582 [53].

53 While informed consent is appropriate in a one-on-one context where the person giving the consent is in a position to understand and discuss the conflict directly with their solicitor, we do not think informed consent can be achieved in the class action context.

54 We support the relevant information being included in notices to group members, but do not think that doing so should be regarded as giving rise to informed consent. Often conflicts of interest are complicated and difficult for even experienced legal practitioners to grapple with, let alone group members who may have little or no experience with litigation. Moreover, most group members are likely to see their participation in class actions as being on a 'take it or leave it' basis – that is, without scope for negotiation of the terms of engagement.

55 As discussed further below, in our opinion, the only effective way to deal with conflict issues is for the solicitors bringing the claim to actively manage them. This process would be assisted by strictly prohibiting direct conflicts (as the Commission has proposed), and also by prohibiting indirect conflicts and by enhancing the Court's supervisory role (by having judges actively monitor and manage conflict issues in the course of their case management processes).

Active supervision by the Court is essential

56 In our opinion, the Court's role in supervising conflicts of interest should be bolstered by appropriate amendments to the Practice Note (GPN-CA). We consider that those amendments could include:

(a) An obligation on the representative plaintiff's solicitors to disclose to the Court at the first case management conference any potential conflicts of interest that may affect their ability to act in the best interests of the representative plaintiff and/or the class (arising from the funding arrangements or otherwise), including:

(i) any commercial or personal relationship between the solicitors and any litigation funder; and

(ii) any retainer, contractual relationship or informal reciprocal arrangement between the solicitors and the litigation funder (or their respective associated entities).

(b) An ongoing obligation to notify the Court if any new conflicts or potential conflicts arise after the first case management conference.

(c) An obligation to disclose the funder's conflict management policy at the same time that the litigation funding agreement is disclosed.

57 Ultimately, it is only on this case-by-case basis that instances of conflict can be identified and adequately managed. In our opinion, it is appropriate that the Court undertake this role because:

(a) solicitors are officers of the Court and owe their paramount duties to the Court;

(b) the Court already has a supervisory role with respect to solicitor's ethics and has the power to sanction solicitors for engaging in conduct that may be contrary to the solicitor's duty to their client or the Court;

(c) the Court has a supervisory protective role in respect of group members; and

(d) the Court is uniquely placed to see how the actions of the plaintiff's solicitors impact on the conduct of the proceeding and on group members' interests (including in the context of approving settlements and applications in relation to funding arrangements).

58 For completeness, we note that the supervisory role of the Court in managing conflicts has previously been supported by findings of the Commission in 2000[37] and is recognised by ASIC in Regulatory Guide 248.[38]

[37] Australian Law Reform Commission, *Managing Justice Report*, No 89 (2000) 550-1 [7.126]–[7.128].

Disclosure of funding arrangements in other types of proceedings

59 Finally, we agree with Proposal 4-5 that the Australian Solicitors' Conduct Rules should be amended to require disclosure of third party funding arrangements in any dispute resolution proceeding, including arbitral proceedings.

60 There is no reason not to extend the requirement to non-representative proceedings. From a defendant's perspective, the same issues arise in relation to adverse cost protection in non-representative proceedings as in class actions.

61 There is also strong support for this proposition in the arbitration community. In that respect, the ICCA-Queen Mary Task Force Principles on Third-Party Funding include the following statement:

> Arbitrators and arbitral institutions have the authority to expressly request that the parties and their representatives disclose whether they are receiving support from a third-party funder and, if so, the identity of the funder. [39]

62 In addition, legislation in Hong Kong and Singapore now imposes mandatory disclosure of third party funding arrangements in arbitration or tribunal proceedings.[40] Similarly, arbitration centres have proposed or implemented rules which mandate disclosure in relation to third party funding.[41] While in Australia, ACICA does not currently require disclosure of funding arrangements, we understand that the issue is under consideration.

CHAPTER 5: COMMISSION RATES AND LEGAL FEES

63 Chapter 5 of the Discussion Paper addresses issues concerning commission rates and legal fees in class action proceedings. In particular, the Commission has proposed that:

(a) the ban on lawyers charging contingency fees be lifted in certain circumstances in class action proceedings, with leave of the Court; and

(b) there be an express statutory power for the Court to reject, vary or set the commission rate in third party funding agreements or contingency fee arrangements.

64 The Commission has also questioned whether there should be statutory limitations on contingency fee arrangements and commission rates, and whether there is a need for a fund to facilitate claims that cannot attract third party funding.

65 Lifting the ban on contingency fees (even in the limited circumstances proposed) would be a very significant development. In our opinion, it is a step that should not be taken lightly given the potential for it to further exacerbate the conflicts of interest issues discussed above and in the Discussion Paper. This is particularly the case in circumstances in which there is no evidence (or, in our view, reason to think) that doing so would improve access to justice in the class action context.

66 We recognise, however, that there is momentum in favour of permitting contingency fee arrangements for plaintiff lawyers in certain contexts. If contingency fee arrangements are to be allowed in class actions, we agree with the Commission that this must be in a controlled manner and subject to approval (and close supervision) by the Court. This can be achieved through increasing the Court's statutory powers to oversee and vary commission arrangements (as the Commission proposes). We support the Commission's proposal that the Court be given clear

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[38] Australian Securities and Investments Commission, *Regulatory Guide 248*, ASIC [248.90] <https://download.asic.gov.au/media/1247153/rg248.pdf>.

[39] International Council for Commercial Arbitration, *Report on the ICCA-Queen Mary Task Force on Third-Party Funding in International Arbitration*, ICCA Report (April 2018) 81.

[40] *Arbitration and Mediation Legislation (Third Party Funding) (Amendment) Ordinance 2017* (Hong Kong); *Legal Profession (Professional Conduct) Rules 2015* (Singapore).

[41] *Hong Kong International Arbitration Centre Arbitration Rules,* proposed Article 44; *Singapore International Arbitration Centre Investment Arbitration Rules,* Rule 24(I).

statutory powers to control commission rates and any contingency fee arrangements. It is also imperative that the 'loser pays' rule remains in place as an important disincentive for the bringing of purely speculative claims.

67 As to the Commission's questions, while we support the intent of a 'statutory cap' on commission rates and contingency fees, we are of the view that a statutorily mandated cap will be counterproductive as it may give undue legitimacy to commission/fee structures at the higher end of the capped range and also distort settlement negotiations.

Contingency fees are unlikely to improve access to justice

68 Proposal 5-1 involves the ban on contingency fees being lifted for solicitors acting for representative plaintiffs in class action proceedings in the following circumstances:

(a) the proceeding is not directly funded by a third party funder;

(b) the solicitor is not otherwise charging professional fees on a time-cost basis; and

(c) the solicitor undertakes to advance the costs of disbursements and indemnify the representative plaintiff for any adverse costs orders.

One of the main reasons given by the Commission (at 5.41) for proposing this change is that it would improve access to justice for mid-sized class action claims.

69 In our opinion, lifting the prohibition on contingency fees is unlikely to achieve the objective of improving access to justice in the class action context. In short this is because, in the current entrepreneurial class action environment characterised by increased filings and more lawyers and funders promoting class actions than ever before, we are not aware of any evidence that meritorious claims are not being brought due to a lack of funding.

70 We do not think that allowing lawyers to charge on a contingency basis will have a material effect on case selection. This is because, in our experience, class actions suitable for funding on a contingency fee basis are already being brought with the backing of third party funders or, alternatively, by lawyers on a 'no win, no fee' or other conditional fee basis.

71 Indeed, in our experience, many small or mid-sized class actions are already being prosecuted, often without the backing of a third party funder, by lawyers on a conditional fee basis. For example, the following cases were all run and settled on a 'no win, no fee' basis without a funder involved:

(a) the Bonsoy milk class action which settled for $25m;[42]

(b) the Black Saturday bushfires case which settled for $494.7m;[43] and

(c) the hip implants class action which settled for $250m.[44]

72 For these reasons, our view is that, rather than improving access to justice in the class action context, introducing contingency fees will simply change the way some cases are funded. In that respect, we agree with the Commission's comments at 5.18 of the Discussion Paper that it is likely that the main effect of introducing contingency fees is that small or mid-sized actions (of the kind mentioned above) would be pursued on a contingency basis rather than a 'no win, no fee' basis. This would not improve access to justice and may well result in larger deductions from group members' returns should those proceedings be successful.

[42] *Downie v Spiral Foods* [2015] VSC 190.
[43] *Matthews v AusNet Electricity Services Pty Ltd* [2014] VSC 663.
[44] *Smith v Australian Executor Trustees Limited* [2016] NSWSC 17 [9].

73 To the extent that the lifting of the ban on contingency fees does encourage the pursuit of claims that would otherwise not have been filed, there is a real risk that the additional claims that will be pursued will be those that are of a highly speculative nature.

Competition and lower commission rates

74 The Commission has also indicated (at 5.11 and 5.34) that it expects the introduction of contingency fees will promote competition and put downward pressure on third party funding commission rates.

75 Recent developments in third party funding suggest that competition between third party funders (and Court intervention) is already driving down the cost of funding. The various shareholder class actions being prosecuted against AMP are a recent example of this, with certain funders agreeing to commission rates as low as 10% of net proceeds of the action.[45] In circumstances where solicitors acting on a contingency will consider that they are taking on the same risk as third party funders, there is little reason to expect that they would seek a percentage return that is materially lower than is currently being sought by third party funders.

76 However, we acknowledge that having only one promoter (rather than two as is currently the case in third party funded cases) may reduce the overall costs of class action litigation for group members and defendants. As mentioned elsewhere in our submission, class action settlements are often negotiated on the basis that the defendant is expected to pay an amount that is sufficient to cover the representative plaintiff's legal costs and the funder's expected return. If the third party funder is taken out of this equation, the overall amount allocated for legal and funding costs may be lower with the consequence that more of a settlement or judgment amount may go to group members.

77 That said, we do not understand there to be any proposal to prohibit third party funding which means that the 'two mouths to feed' issue will still exist in third party funded cases. Moreover, as mentioned above, class actions that are funded by lawyers on a contingency basis may well involve higher transaction costs than those funded on a conditional fee basis.

Protections and safeguards if contingency fees are permitted

78 If contingency fees are to be permitted in class action proceedings, we agree with the Commission that it is essential that protections and safeguards be put in place to avoid excesses and manage potential conflicts. In particular, Proposals 5-1 and 5-2 that:

(a) the restriction of contingency fees to proceedings that are not otherwise funded, to prevent the dangers of 'double charging' on a contingency basis to the detriment of the group members;

(b) the prohibition on 'hybrid' arrangements that would allow lawyers to charge both time-based and contingency fees for different parts of the same proceeding – this is, as the Commission recognises, a recipe for confusion for group members;

(c) under a contingency fee agreement, solicitors must advance the cost of disbursements and indemnify the representative class member against adverse costs orders; and

(d) the requirement for lawyers to obtain the leave of the Court before entering into contingency fee arrangements and the ongoing supervision of the arrangement by the Court.

79 In our opinion, in order to achieve the desired effect, the prohibition on 'hybrid' arrangements would need to apply to counsel's fees (in addition to solicitor's fees).

[45] See, for example, 'Class action lawyers fight over the $2b AMP pie', *Australian Financial Review*, 18 May 2018.

80 As discussed above, we consider that the Court has an important role to play in managing conflicts of interest. Permitting solicitors to take a direct commercial interest in the outcome of class action proceedings introduces greater risks of conflicts arising between interest and duty which will need to be appropriately monitored and managed. Empowering (and requiring) the Court to proactively oversee these contingency arrangements is an important check on the potential for conflicts to go unmanaged should contingency fees be permitted.

81 Other checks and balances that we consider may be appropriate include the following:

(a) It is imperative that there be no change to the costs shifting or 'loser pays' rule that requires an unsuccessful plaintiff to pay the costs of the defendant. In our opinion, this is an extremely important check against the bringing of speculative claims in the current system and will become even more important if contingency fees are introduced.

(b) We think it would be helpful if contingency costs agreement are required to be in a prescribed standard form. At the very least, regulation should require that:

(i) clients have measures of control over the costs agreement, including a cooling-off period and the right to terminate in appropriate circumstances;

(ii) cost agreements contain comprehensive disclosures - including specifying the contingency fee, defining 'success', disclosing all potential costs and the right to seek independent advice before an agreement is finalised, and a requirement that the agreement and any variations to it be made in writing;

(iii) provision for security for costs and adverse costs orders to be enforced directly against lawyers charging contingency fees, with appropriate regulation about how this occurs – this is appropriate because the parties with financial interests in the litigation should bear the financial risks associated with it; and

(iv) fees charged are consistent for all group members and disclosed to all group members.

(c) The disclosure of the costs agreement to the Court at the commencement of proceedings, as well as to group members and the defendant's representatives.

(d) Should plaintiff lawyers be permitted to recover a contingency fee and plaintiffs are also entitled to an award of costs, the awarded costs should be applied in reduction of the contingency fee.

(e) A regime for specifying how the regulation of contingency fees would interact with the proposed licensing of litigation funders (i.e. whether law firms charging contingency fees should be required to hold a licence or maintain minimum capital reserves). At a minimum, prudential requirements requiring lawyers to hold sufficient capital reserves to meet adverse costs or security for costs orders would appear appropriate.

Exceptions

82 In response to Question 5-1, in the event that the prohibition on contingency fees is lifted for class actions, we consider that the prohibition should remain in place for personal injury litigation.

83 In essence, this is for the reasons set out in paragraph 5.42 of the Discussion Paper. Most importantly, the nature of the heads of damage available in personal injury matters - particularly for future care and loss of future earnings.

Express statutory power to oversee funding arrangements

84 We support Proposal 5-3 that the Court be given an express statutory power to oversee and regulate funding arrangements, whether on a third party commission basis or a contingency fee basis.

85 We agree with the Commission's observation that it is important that the Court play a role in ensuring that the deductions from any settlement or judgment for legal and funding costs are reasonable and appropriate, and that the administration of justice would benefit from certainty regarding the scope of the Court's powers in this regard. The benefits of making this power clear were illustrated in the settlement approval for the Newcrest shareholder class action. In that case, it was submitted (by the solicitors representing the class) that the Court did not have the power to reduce the funding commission rate if it decided it was not fair to group members.[46] The very fact that the representatives for the class made this submission also highlights the extraordinary conflicts that can arise in the class action context.

86 If the contingency fee proposal is adopted, we support extending this power to the variation of contingency fee agreements (as well as third party funding commissions). For the reasons stated above, we are of the view that the Court should actively monitor the reasonableness of contingency fee arrangements during the life of the proceeding (including on settlement).

87 As noted in Chapter 6, we also support the Commission's Proposal 6-1 that litigation funding agreements should be enforceable only with the approval of the Court.

Statutory caps on commission rates and contingency fees

88 Question 5-2 asks whether there should be statutory limits on the amount of commission paid under funding arrangements or legal fees payable under contingency fee arrangements. It is suggested that there could be a sliding scale or a maximum cap of 49.9% of any settlement or judgment.

89 We share the Commission's concerns as to the proportion of settlements that are being paid to lawyers and funders. Aside from the examples mentioned in the Discussion Paper, there is also the more recent settlement approval of the class action against Bank of Queensland[47] where it was initially proposed that group members would only be entitled to approximately 30% of the settlement amount after legal fees and commission had been deducted.[48] Where cases settle for lesser amounts, often because the case was weak, the lawyers and funders who promoted the case should accept lower returns, rather than diluting the returns of the group members.

90 That said, particularly having regard to recent examples, and consistent with the view of the Victorian Law Reform Commission in its recent report[49] we ultimately think that the best way to achieve this is through Court oversight of funding commission and contingency fee rates (as the Commission proposes in Proposal 5-3) on a case by case basis rather than through the imposition of a statutory cap for the following reasons:[50]

(a) Rather than serving as a maximum, the statutory cap may become to be seen as a default rate. There is a risk that the view will be taken that anything under the cap is likely to be approved, with plaintiffs' solicitors and funders decreasing their rates well below the capped amount only in cases where there is a risk that they will be undercut (for example, where there is a competing action). Particularly where lawyers or funders are seeking a common fund order upfront in the proceedings, before the Court can properly assess proportionality, there is a risk that the introduction of statutory cap will actually increase fees. As the Commission notes at 5.71, this is exactly what has happened with uplift fees where the maximum 25% uplift has now become the norm.

[46] *Earglow Pty Ltd v Newcrest Mining Limited* [2016] FCA 1433 [148]-[158]. Similar issues are also currently being considered by the Court in the settlement of the CDO class actions against Standard & Poor's.

[47] Federal Court Proceeding NSD362/2016.

[48] Lawyerly, *Judge slams class action settlement as 'worst' he's ever seen* (25 May 2018) Lawyerly <https://lawyerly.com.au/judge-slams-class-action-settlement-worst-hes-ever-seen/>.

[49] Victorian Law Reform Commission, *Access to Justice - Litigation Funding and Group Proceedings*, Report (2018) [5.77] - [5.85]. .

[50] While we initially supported the imposition of a statutory cap, in the current environment and given the greater preparedness of courts to scrutinise funding fees, we consider that the preferable course is court oversight on a case by case basis.

(b) A statutory cap may also serve as an unhelpful 'anchoring point' in settlement discussions. This would occur if, for example, the plaintiff lawyer and/or funder have a minimum amount they need to recover from the class action. In those circumstances, it can be expected that pressure will be brought to bear on the defendant to agree to a settlement that meets their expectations but also complies with the cap – at least in some circumstances, this can be expected to scupper settlement discussions. Rather than leaving it to the defendant to argue that promoters should reduce their fees in the interests of group members or supplement the settlement amount to comply with a statutory cap, the lawyers and funder should be required to justify their fees to the Court as part of the settlement approval hearing. This is what, we understand, has occurred in the Bank of Queensland case mentioned above (and also the other cases mentioned in the Discussion Paper).

91 If, however, some form of statutory cap is to be introduced, we consider that it should be an aggregate cap – that is, the cap should apply to both total legal fees and funding commission.

Chapter 6: Competing class actions

1 As discussed above, entrepreneurialism, including additional law firms seeking out greater profit making opportunity through class actions, has been a core contributor to the rise of competing class actions in recent years. In the first six months of 2018 alone, our research indicates that approximately 42% of class actions filed are competing class actions and such competing claims were brought by nine different firms.

2 Competing class actions have a number of undesirable consequences. In most cases, there is little real justification for paying multiple sets of lawyers to run multiple claims when class members could be effectively represented in a single claim by a single legal team.

3 Aside from the duplicated costs, in our experience, competing class actions have the potential to put both group members and defendants in an invidious position:

(a) For defendants, there are often significant additional costs in dealing with multiple sets of proceedings which often involve different (albeit overlapping) issues. Indeed, simply dealing with multiple sets of lawyers significantly increases the cost burden.

(b) For group members, multiple claims give rise to confusion and, in cases where group members are asked to choose between claims, significant stress in being required to make a decision that many are ill-equipped to deal with. Moreover, the costs associated with multiple proceedings is likely to reduce overall group member recovery.

4 Competing class actions also impose an additional burden on the Court in direct contradiction with one of the key objectives of the class actions process – to promote efficiency in the judicial system by dealing with a large number of claims arising out of the same or similar issues simultaneously.

5 In circumstances in which competing class actions would appear to be prejudicial to the parties and the Court, we consider that there is a pressing need for the Court to take a proactive approach to managing competing class actions. The current situation involving AMP facing competing class actions across multiple jurisdictions only further highlights the need for reform to be implemented as a matter of priority.[51]

6 As identified by the Commission, and reflected in our own research (see Figure 2 above), the majority of competing class actions occur in the shareholder class action context, no doubt because of the commercial opportunity presented by the scale and potential quantum of such claims. For this reason, we consider that the proposed broader review of the continuous disclosure regime, which we support and discuss above, is also an important step in addressing competing class actions.

7 For those reasons, we generally support Proposals 6-1 and 6-2 which are directed towards addressing these issues by expressly empowering the Court to select a single case to proceed in the vast majority of circumstances in which competing claims are filed. We do not, however, express a view on the Commission's proposal that the Court's approval of funding arrangements for all class actions be on common fund basis.

Open classes

8 A key element of Proposal 6-1 is that, as a matter of policy, Part IVA of the Federal Court Act should be amended to provide that all class actions be initiated as open class actions. We

[51] Four class actions against AMP have been filed in the Court (file numbers VID670/2018, VID680/2018, NSD878/2018 and VID535/2018) and one class action against AMP has been filed in the NSW Supreme Court (file number 2018/00145792). See also our discussion in our VLRC Submission [5.18]–[5.20]; Discussion Paper [1.83].

support this proposal and note that it is consistent with the original objectives of the class action regime, being access to justice, efficiency and finality.

9 It is also consistent with the essential nature of the regime as an opt-out regime. In that regard, we agree with the comments made by Justice Stone in the Aristocrat case that opt-in (or closed class) cases are 'repugnant to the policy' of the opt-out regime.[52] While a quirk in the drafting of Part IVA may ultimately have led to the ratification of closed classes,[53] it is does not change the fact that they remain repugnant to the policy of the opt-out regime.

10 From a defendant's perspective, closed classes are a particular problem because they impede finality, create uncertainty and lead to the undesirable 'Whac-A-Mole' scenario posed by Justice Lee in the context of the GetSwift case[54] and discussed at 6.12 of the Discussion Paper.

11 As the Commission notes, the acceptance of closed classes has contributed to the number of competing class actions commenced in recent years. However, we doubt that a move away from closed classes would necessarily reduce the number of competing class actions, given the recent acceptance of the common fund approach. Although the Full Court in the *Money Max* case originally suggested that common fund orders could assist in resolving the competing class actions problem,[55] we have seen an increasing number of competing class action filings after that decision with competing proposals for common fund orders.[56]

Definition of competing class actions

12 We agree with the Commission's broad definition of competing class actions (at 6.30) by reference to overlapping group membership. However, the question of whether all classes are truly identical should be carefully considered by the Court so that all claims are litigated together and finality achieved. For example, the Court should be alive to the inherent subjectivity in the way that some class definitions are formulated as observed by Justice Lee in *GetSwift*.[57]

Carriage motions

13 We support the introduction of a 'carriage motion' procedure into the Federal Court Act whereby there is a limited amount of time to bring any competing claims, and then a selection hearing to determine which claim should proceed, with the remaining claims permanently stayed by the Court.[58]

14 Such a proposal is consistent with our general view that there is a need for greater upfront scrutiny of the appropriateness of class action claims.[59] As we discuss below, a carriage motion procedure will play a role in ensuring there is appropriate scrutiny of the core issues in a class action at an early stage so that time and resources are not wasted and the interests of group members properly protected.

Timelines for filing competing class actions

15 We support the key interlocutory steps proposed by the Commission to implement Proposal 6-1, as outlined in paragraphs 6.46 to 6.48 of the Discussion Paper. We do not think it is appropriate

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[52] *Dorajay Pty Ltd v Aristocrat Leisure Ltd* [2005] FCA 1483; (2005) 147 FCR 394 at [125]-[126].

[53] *Multiplex Funds Management Ltd v P Dawson Nominees Pty Ltd* [2007] FCAFC 200; (2007) 164 FCR 275.

[54] *Perera v GetSwift Limited* [2018] FCA 732 [16]

[55] *Money Max* [2016] FCAFC 148 [14].

[56] See, for example, *Perera v GetSwift Limited* [2018] FCA 732 [18] where all class actions were commenced on an open class basis and a common fund order was sought in one of the three competing class actions.

[57] See *Perera v GetSwift Limited* [2018] FCA 732 [76]–[82].

[58] Discussion Paper [6.28]; Allens, Submission to Victorian Law Reform Commission, *Litigation Funding and Group Proceedings,* [5.25].

[59] VLRC Submission [5.6]–[5.10]. See our article "Is it time to revisit our class action gateways?" in Allens '25 Years of Class Actions: Where are we up to and where are we headed' (25 March 2017), https://www.allens.com.au/pubs/class/papclass27mar17.htm.

that the 'first in, best dressed' concept should determine how the Court addresses competing class actions as class action promoters should not be discouraged from properly scoping and investigating a potential class action claim before filing.

16 We agree that the timeline set for lodging competing class actions must be carefully considered to appropriately balance the need to allow sufficient time for potential class action claims to be thoroughly considered against the need to avoid causing undue delay to the class action(s) already on foot.

17 The timeline that will reasonably balance these competing considerations will vary from case to case. Although we suggest that a timeline of approximately three months would generally be appropriate, we consider that setting this timeline should be a matter of discretion for the Court at the interlocutory hearing rather than prescribed.

18 Appropriate guidance should be included in Practice Note (GPN-CA) to ensure that the timeline set for each case achieves the balance described above. Such guidance should identify the factors to be considered to determine an appropriate timeline, including:

(a) the complexity of the claim;

(b) the availability of, access to, documents; and

(c) the potential difficulty with identifying group members.

Factors for selecting which competing class action should proceed

19 We generally agree with the factors that have been identified in the Canadian context, and in the *GetSwift* decision, as the appropriate matters to be considered by the Court when determining which class action should be selected to proceed.[60] From a defendant's perspective, key factors include:

(a) (**funding**) if the class actions are funded:

(i) the security for costs arrangements offered by each funder; and

(ii) the resources available to fund the group members' costs and meet adverse costs orders;

(b) (**moral hazard**) whether the filing of any of class actions raises a 'moral hazard' through the absence of provisions in the funding agreement which guard 'against a funder having an inappropriate role in providing instructions as to settlement';[61]

(c) (**representative plaintiff**) the suitability of the proposed representative plaintiff(s) to represent the common claims of group members, including whether:

(i) there are likely to be potential sources of conflict between the representative plaintiff and group members; and

(ii) determination of the representative plaintiff's claim will adequately address the interests of the group members and resolve the common issues;

(d) (**finality**) the extent to which the selection and determination of that claim will achieve finality for all parties in relation to the underlying conduct at issue.

20 Notwithstanding our support for the Commission's proposal, we agree with the consequential 'Worldcom problem' that may arise as identified by Degeling, Legg and Metzger in their submission to the VLRC's similar inquiry.[62] In particular, we agree that there is a risk that group

[60] [2018] FCA 732 [169]–[170]; Discussion Paper [6.51], 112 [6.43];VLRC Submission [5.27].

[61] *Perera v GetSwift Limited* [2018] FCA 732 [218]–[224].

[62] Degeling, Simone, Michael Legg and James Metzger, Submission to Victorian Law Reform Commission, Access to Justice – Litigation Funding and Group Proceedings Consultation (22 September 2017), 8; see also Michael Legg, Public Lecture Addressing

members may opt-out of the selected class action, perhaps with encouragement of a law firm or litigation funder, and seek to bring individual claims or otherwise undermine the selected class action. This risk, if realised, would therefore threaten the objective of achieving a single binding decision that applies to all claimants.

21 We further agree with Degeling, Legg and Metzger's suggestion to manage this risk – that any individual proceedings commenced by group members who have opted out be stayed pending the determination or resolution of the selected class action.[63]

Role of defendant in selection hearing

22 We note the Commission's proposal to preclude the defendant from participating in the selection hearing on the basis that information revealed in such a hearing might otherwise provide a 'tactical advantage' to the defendant. In reaching this position, the Commission has stated that existing statutory provisions adequately protect the defendant.

23 While we acknowledge that there are existing safeguards in place to protect defendants, these safeguards have not proved effective in practice and the burden has largely rested on defendants to bring applications to ensure that questions as to appropriateness of class action claims are considered. For these reasons, we are of the view that greater upfront scrutiny by the Court of the core issues in a class action claim is required, and is in the interests of both claimants and defendants. For competing class actions, an early selection hearing is one forum in which this can efficiently and effectively occur and in which the defendant has a legitimate role to play.

24 Accordingly, we do not support the Commission's proposal to preclude the defendant from participating on the basis that:

(a) the selection hearing is an important forum in which key issues concerning the appropriateness of the various claims will be considered; and

(b) as the broader issues ventilated at the selection hearing may be determinative of which class action proceeds, it would be both efficient and reasonable for the defendant to play a role.

25 In particular, core issues that require scrutiny at the selection hearing and which would be highly relevant to the defendant and on which the defendant should be heard include:

(a) the nature of the questions of law or fact common to the group;

(b) the adequacy of the representative plaintiff, including whether:

(i) there are likely to be potential sources of conflict between the representative plaintiff and group members;

(ii) determination of their claim will adequately address the interests of the group members and resolve the common issues; and

(c) the security for costs arrangements in place.

26 As noted by the Commission at 6.52, this is consistent with the position in Ontario where it is recognised that the defendant's interest is a consideration for the court in deciding which firm will have carriage.

27 We consider the better approach would be for the defendant to be included in the selection hearing and for the Court to have discretion to require the defendant to be absent from certain parts of the selection hearing where it forms the view that tactics or case theory are reasonably

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Victorian Law Reform Commission Consultation Paper, Access to Justice – Litigation Funding and Group Proceedings (2017) *University of New South Wales Law Research Series* 57, 6.

[63] Degeling, Simone, Michael Legg and James Metzger, Submission to Victorian Law Reform Commission, Access to Justice – Litigation Funding and Group Proceedings Consultation (22 September 2017), 8.

likely to be revealed and unfairly advantage the defendant. In our opinion, this would address the Commission's concern mentioned at paragraph 6.53 in relation to defendants getting a potential tactical advantage by being present during the selection hearing.

28 It follows, for example, that where there is discussion of the merits of each claim or expert witnesses, it would be appropriate for the Court to require the defendant to be absent from that part of the selection hearing. However, where there is discussion of how each class action is constituted or relating to the representative plaintiff, it is important for the defendant to be present.

Judge who will hear selection hearing

29 We have become aware (anecdotally) that there is concern amongst defendants in Canada in relation to the same judge hearing both the carriage motion and subsequently certification for the selected class action.

30 Given the Commission's proposals relating to the matters to be addressed in the selection hearing, in the Australian context, we query whether issues may arise if the judge who deals with selection also then proceeds to ultimately hear the trial of the selected class action. In order to ensure faith in the integrity of our judicial system, we therefore suggest that the Commission consider whether it might be prudent for a separate judge to deal with selection.

Guidance for managing multiple class actions

31 We appreciate that there may be some limited instances in which it may be necessary for multiple class actions to continue in parallel, including where, as raised by the Commission at 6.31 and 6.45:

(a) there is only a small amount of overlap between the multiple class actions; or

(b) there are multiple issues in dispute, involving one or more defendants, which cannot be dealt with by sub-classes; or

(c) 'other complexities' arise such that it would be inefficient or undesirable to stay one or more of the multiple class actions.

32 At 6.32 of the Discussion Paper, the Commission suggests that existing case management tools could be utilised to efficiently manage this scenario. However, given that the Practice Note (GPN-CA) does not currently specifically contemplate the scenario of multiple class actions, we consider additional guidance should be incorporated that to the extent applicable:[64]

(a) the two or more plaintiff law firms are to negotiate as one with the defendant on the discovery categories and electronic discovery protocol;

(b) the two or more plaintiff law firms are to use reasonable endeavours to:

(i) agree on proposed expert evidence;

(ii) consult with each other before preparing, filing and serving any evidence;

(iii) progress each proceeding in a similar manner;

(iv) cooperate in the conduct of any interlocutory applications; and

(v) confer about court timetabling;

(c) the Court may make orders to ensure that the defendant is only exposed to one set of legal costs vis-à-vis the representative plaintiffs as if there has been only one class action.

Such amendments to Practice Note (GPN-CA) would help ensure there is clarity and consistency of approach in managing multiple class actions.

[64] See our suggestions in VLRC Submission [5.28]; see also *McKay Super Solutions Pty Ltd (Trustee) v Bellamy's Australia Ltd* [2017] FCA 947 [112]–[118].

Class closure at mediation

33 We note the Commission's suggestion at 6.29 that class closure at mediation be final. We understand this to mean that the class be permanently closed through a registration process for the purposes of any subsequent settlement or judgment.

34 The Court can exercise its broad, discretionary power in section 33ZF of the Federal Court Act to order class closure at mediation to be final where it 'thinks appropriate or necessary to ensure justice is done', yet in practice the Court has been reluctant to order that class closure at mediation be final.[65] In our view, the Courts should be more prepared to make such orders. From a defendant's perspective, class closure plays a significant role in facilitating settlement of class actions commenced on an open class basis. By group members coming forward and registering their participation, defendants are able to properly assess their potential exposure and, on that basis, seek to meaningfully negotiate a commercial resolution of the proceeding. Given the time, cost and complexity involved in class action claims, encouraging commercial resolution should be a focus of the Court, which would be in the interest of all stakeholders.

35 As the Commission observes, the potential for the class to reopen in the event a settlement is not reached at mediation provides the representative plaintiffs with a tactical advantage in any commercial negotiation. Further, it can impede settlement discussions continuing after an unsuccessful mediation and mean that class closure orders need to be sought a second time should the parties wish to mediate on another occasion.

36 In light of this, and in circumstances where class action claims are well publicised and appropriate steps taken to notify group members of their rights and options upon class closure, in our view there is no compelling policy reason why class closure at mediation should not be final.

[65] See, for example, *Jones v Treasury Wine Estates Limited (No 2)* [2017] FCA 296 [41], noting also *Hardy v Reckitt Benckiser (Australia) Pty Ltd* [2017] FCA 341 [10]–[11]; see also Vicki Waye and Vince Morabito, 'When Pragmatism Leads to Unintended Consequences: A Critique of Australia's Unique Closed Class Regime' 19 *Theoretical Theories L.* 303 (2018) 317, which notes that more recently, class closure orders have been issued earlier 'in order to support prompter settlement'.

Chapter 7: Settlement approval and distribution

1 This chapter addresses settlement approval and distribution of settlement proceeds. Particularly in circumstances in which a large percentage of class actions settle, these are important issues which require careful consideration.

Court-appointed costs referee

2 We support Proposal 7-1 that the Practice Note (GPN-CA) be amended to expressly permit the appointment of a costs referee to assess the reasonableness of costs charged in a class action prior to settlement approval (and that the referee is to explicitly examine whether work completed was done in the most efficient manner). This course has already been adopted by the Court in class actions involving significant legal costs.[66]

3 In our opinion, the Court's power to appoint a costs referee should not, however, be confined to the time of settlement approval. In the Discussion Paper, the Commission expressed the concern that affidavits prepared by cost consultants are often only provided on the day of the hearing, leaving the Court in a position where it is unable to properly assess that evidence. Although this concern is addressed to some extent by delegating the review of the plaintiff's legal costs to a referee, the Court retains ultimate responsibility to ensure that those costs (in the context of the settlement as a whole) are fair and reasonable. Being provided with a report from a costs referee (in addition to, or in substitution of, a costs consultant's report) shortly before a settlement approval hearing still leaves the Court in a position where it is seeking to supervise costs in the interests of group members long after those costs have been incurred and at a time in which it is just not practical to consider the issue other than at a macro level.

4 For that reason, we submit that the Practice Note (GPN-CA) should provide that, in appropriate circumstances, the Court should consider appointing a costs referee to supervise the plaintiff's costs periodically throughout the course of the proceeding. This concept was adopted by Justice Lee in *Perera v GetSwift Ltd.*[67] His Honour relevantly remarked that '[t]he ongoing involvement of a referee as proposed would serve to obviate the necessity for a referee or independent cost consultant to go back at a section 33V stage and check all the costs incurred during the course of the proceeding'. Such a review by a costs referee at various stages of the proceeding would likely also result in a more meaningful assessment of legal costs than would be the case if costs were only assessed at the end of the proceeding (which is often a considerable period of time after the costs were incurred).

5 In our opinion, a periodic review by a costs referee should become standard practice in major class action litigation. Regular assessment of the plaintiff's accumulated legal costs could reasonably be expected to advance the interests of both group members and defendants (who may have ultimate responsibility to pay costs, either as part of a settlement or following a judgment). In this respect, in *Perera v GetSwift Ltd*,[68] Justice Lee said that 'a heightened discipline over interlocutory steps such as discovery, by requiring a referee to, in effect, sign off before such work is recoverable, is just one illustration of the real utility' of a periodic process.

6 Having costs audited on a periodic basis is also likely to assist settlement negotiations (which usually involve a costs component) to proceed on a more informed basis, as the defendant would have greater confidence that any amounts claimed in respect of costs have been assessed as appropriate by a court-appointed referee.

[66] See, for example, *Money Max Int Pty Ltd (Trustee) v QBE Insurance Group Limited* [2018] FCA 1030.
[67] [2018] FCA 732 [227].
[68] [2018] FCA 732 [228].

7 On a different note, we are strongly of the view that this process should apply even if the solicitors are changing on a contingency fee basis (if that becomes permitted). This is because, in the event that the defendant is required to pay the plaintiff's costs, those costs should be subject to significant scrutiny (perhaps even more so if there was never any possibility that they would be charged to a client, as would be the case under a contingency fee arrangement).

Administration costs

8 As the defendants we represent ordinarily have no involvement in (or visibility of) the settlement distribution process, we do not consider ourselves well-placed to comment on Question 7-1 in relation to the settlement administration process. We do, however, support the general proposition that it is in group members' (and also defendants') interests that the costs of settlement administration be minimised.

Settlement confidentiality

9 Question 7-2 asks whether the terms of class action settlements should be made public. The arguments in favour of disclosing the terms of settlement are said to be that it supports transparency and open justice. There is also a suggestion that disclosure is justified by reference to the 'public function' of class actions.

10 We do not consider that either of these factors outweighs the obvious benefits of encouraging settlement of what is ultimately a private action by a group of individuals. Confidentiality in the terms of a negotiated settlement in a class action will often have value to at least one of the parties (as is the case in non-representative proceedings) – for that reason, a blanket prohibition on confidentiality is likely to be an obstacle to settlement. The Court currently has a wide discretion to balance that private interest against the public interest in transparent and open justice, and can decide on a case-by-case basis whether or not to grant confidentiality orders. We consider that the Court is best placed to make this assessment, and recommend that it should retain the discretion in this respect. As noted by Justice Perram in the PIF class action, the Court exercises a protective jurisdiction in the interest of all group members, with full knowledge of every detail of the settlement agreement.[69]

11 To be clear, we do not propose that the terms of settlement should be confidential from group members. Group members should be given the opportunity to obtain a copy of the terms of settlement on a confidential basis, and it is appropriate that any notification of a proposed settlement include procedures for this to occur. We do not, however, see a justification for broader disclosure absent compelling circumstances. As Justice Foster stated in the Allphones class action, '[t]here was and is no public interest in terms [of the settlement] being made public … only the group members and [the defendant] have a legitimate interest in ascertaining the details of the settlement'.[70]

12 Apart from the general desire for confidentiality over the terms of compromise agreed in particular cases, there are also a variety of specific reasons why the Court (as well as various state courts) have been willing to keep confidential the whole or part of settlement agreements in class actions including the following:

(a) Settlement terms have been made confidential where the disclosure of that information would cause prejudice to the parties or to third parties. For example, Justice Beach ordered in one of the Gunns class actions[71] that the terms of a settlement reached between the defendant and a closed group be kept confidential, since disclosure could interfere with the proper processes for any aggrieved person who fell outside the closed group to legitimately

[69] *Hodges v Waters* [2015] FCA 264 [67].
[70] *Weimann v Allphones Retail Pty Ltd* [2011] FCA 537 [31].
[71] *Foley v Gay* [2016] FCA 273 [30].

consider and pursue their rights against the defendants. Similarly, in the Airsevices class action, Justice Bennett made a confidentiality order in respect of a settlement sum and distribution schedule after the defendant had argued that publicising that information would be prejudicial to it.[72] According to the defendant, there were other individuals who found themselves in the same situation as the members of the closed group and could use the settlement in potential subsequent proceedings against the defendant.

(b) Where settlement agreements contain sensitive commercial information, the courts have been willing to order that those agreements not be disclosed. For example, in the Allphones class action, Justice Foster preserved the confidentiality of a settlement agreement, given that the settlement 'involved sensitive commercial dealings of a confidential nature', namely the terms of franchise agreements that were renegotiated as part of the settlement.[73]

[72] *Fowler v Airservices Australia* [2009] FCA 1189 [36].
[73] *Weimann v Allphones Retail Pty Ltd* [2011] FCA 537 [31].

Chapter 8: Regulatory collective redress

1 We agree with the Commission'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.

2 It is important that the 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 we support 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.

3 In response to Question 8-1, 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 must have the following characteristics:

(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.

We have addressed each of these characteristics below.

Finality and certainty for the potential defendant

4 As noted above, it is essential that any redress scheme 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 (although we acknowledge that a right to opt-out would need to be provided); and

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

5 The opt-in approach that would appear to be envisaged by the Commission (having regard to paragraph 8.20) 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 This was the case with the opt-in scheme implemented by the Commonwealth Bank through which it offered $268 million in compensation to customers who had suffered losses as a result of the collapse of Storm Financial. A class action was also commenced in respect of those losses. The class action was settled, after five years of litigation with all of the associated costs, on a basis that involved group members being paid the same amount that had been offered under the scheme. In this scenario, both group members and the Bank were worse off than would have been the case had all claims been resolved through the scheme (because of the costs and delays associated with the litigation).

7 A similar situation arose after Downer EDI Ltd negotiated a settlement with IMF Bentham after it had been threatened with a shareholder class action. That settlement agreement was not binding on all affected persons and a class action was subsequently brought on behalf of persons who were not compensated through the IMF settlement.

8 These unsatisfactory situations would be avoided by a collective redress scheme that was binding on all potential beneficiaries, subject to a right to opt-out. That approach would also be consistent with the opt-out nature of the class action regime and is the model adopted in the Netherlands under its *Collective Settlement of Mass Damages Act 2005* (NL).[74] That regime has seen some high-profile international claims successfully resolved. For instance, in a recent decision, 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.[75]

9 For similar reasons, implementation of 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 Dutch *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

10 While we accept 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.

11 It is fundamental to our justice system that an alleged wrongdoer should have the right to have the question of 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 thus inform future conduct.

12 For that reason, it is important 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* in the United Kingdom, and also under similar scheme in the Netherlands.[76]

No admission of liability

13 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.

14 In our opinion, requiring any such admissions would be both 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

[74] 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.

[75] 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; 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>.

[76] *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>.

one is not necessary for the other). It is counter-productive in that it is likely to be a 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 (including by allowing people to opt-out).

15 Moreover, even a scheme that does resolve liability on a once and for all basis in this jurisdiction, would not absolve the potential liability issues associated with an admission for companies that may also face exposure in other jurisdictions.

16 Incidentally, we note that requiring an admission was identified as a 'fundamental shortcoming' of the Latvian *Consumer Rights Protection Act 1999* (LV) in a recent European Commission report on the status of collective redress in the European Union.[77]

Confidentiality

17 We recommend that any information shared with regulators while addressing the conduct that ultimately results in a collective redress scheme be treated confidentially.

18 Claimants who opt-out of 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.

19 Consistent with this approach, the UK Competition and Markets Authority has determined that all communication with the board which is to set up the scheme takes place on a without prejudice basis, and cannot be adduced as evidence in court proceedings.[78] Similarly, the CMA will generally treat applications for approval of a scheme as confidential.[79]

Reduction of regulatory penalty

20 We acknowledge (and agree with) the Commission's suggestion that the possibility of a lower regulatory penalty in recognition of a potential defendant's willingness to enter into a voluntary redress scheme is an important incentive in encouraging potential defendants to take that step.

21 In this regard, we note that the UK CMA has indicated that it will grant a reduction of fines by up to 20% for companies who voluntarily propose redress schemes.[80]

[77] European Commission, *State of Collective Redress in the EU in the Context of the Implementation of the Commission Recommendation*, 2018, 733, <http://ec.europa.eu/newsroom/just/document.cfm?action=display&doc_id=50236>.

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

[79] Ibid 38 [3.8].

[80] Ibid 46 [3.30].