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To Australian Law Reform Commission
GPO Box 3708
Sydney NSW 2001
By email: class-actions@alrc.gov.au

Dear Commissioner

Inquiry into Class Action Proceedings and Third-Party Litigation Funders

We refer to the terms of reference for the inquiry into class action proceedings and third-party litigation funders and the invitation that we have received to make submissions on the Discussion Paper.

We welcome the opportunity to provide a submission to this inquiry. King & Wood Mallesons has acted in a number of class actions involving third-party litigation funders and generally represents defendants in these matters. As such, the firm has a significant level of insight into the issues canvassed by the Commission.

We have set out our responses to the proposals and recommendations below.

We make one general observation. The proposals in the Discussion Paper highlight the need for a uniform Commonwealth/State approach. Many matters, such as the concept of contingency fees, are dealt with under individual State costs regimes, which would have to be addressed. A theme of some of the proposals is that the Federal Court be given an exclusive jurisdiction for certain matters, such as Question 6 – 1. Such an objective may run counter to State matters. Similarly, some suggested reforms, if limited to a Commonwealth sphere, may be avoided by actions in the State Supreme Courts. Such a device for the circumvention of the proposals cannot be intended.

1 Introduction to the Inquiry: Shareholder Class Actions

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

(a) the propensity for corporate entities to be the target of funded shareholder class actions in Australia;

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

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

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1.2 KWM Response to Proposal 1-1

1 KWM is generally supportive of the proposal to commission a review of the legal and economic impact of the continuous disclosure regimes on listed entities. The prevalence of shareholder (or securities) class actions is well-known.[1] As noted in the Discussion Paper,[2] shareholder and investor class action filings have been steadily increasing, and now represent approximately a third of all filed class actions.

2 KWM supports any review which might address, or shed light on, the issue of circularity which arises when a class action is commenced against a listed entity, impacting its share price, by the shareholders of that entity. While the share price of the listed entity is often affected by the revelation of the alleged misleading and deceptive conduct, or non-compliance with continuous disclosure obligations, in our experience the price is also affected, in part, by the pending prospect of a class action being filed. Some of these issues were highlighted, although not able to be pursued due to standing, in the recent decision in *Morris v IMF Bentham Limited*.[3] The role of plaintiff law firms and funders during the "book build" phase of a class action, particularly the public announcements about the foreshadowed class action, can impact a share price. Often highly inflated, unrealistic figures are used which bear little resemblance to any realistic damages assessment.

3 The ironic twist of many securities class actions is that the conduct of the action itself deflates the share price of the company, thus impacting shareholders who are members of a class. The proposed review should certainly consider any analysis of the fate of a share price after the announcement of a class action.

4 An element that often features in securities class actions is that the initial claim is based purely on inference. It is inferred that a market announcement of a drop in profit or a revaluation of certain assets is indicative of an error or negligent action by the company during an earlier period. Often, the claim has no more and the plaintiff class must obtain discovery of documents from the company in order to "make the case". Often, as mentioned above, large numbers are thrown around during the book build stage but ultimately far less financially is really in issue when a matter settles, especially with the lack of trial decisions in this area. Hence, there is often little discipline brought to bear in the compilation of a claim, simply the drive to issue proceedings and create the environment where access to confidential material is effectively sanctioned through the court processes. We would support some form of initial class action certification to the Court, such as is used in the US, to weed out those claims which have fishing rather than genuine prospects.

5 Under the US certification regime, the plaintiff bears the onus of proof and the Court must certify that the matter is one that should proceed as a class action at an early stage after the matter is filed. If the ALRC was minded to recommend a certification regime, we suggest that consideration should be given to also requiring a plaintiff to articulate its case on causation and loss. This will require the plaintiff to identify a cogent arguable case for recovery rather than the generalised large figure approach of many matters. The form of defence filed in the GetSwift matter on 9 July 2018 is a good example where the amount claimed was $75 million, far short of the spruiked figure of $300 million.

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[1] See e.g. *Perera v GetSwift Limited* [2018] FCA 732 at [24].

[2] Discussion Paper at [2.15]-[2.17].

[3] [2018] FCA 1009.

6 A further issue, which remains somewhat untested in Australian law by trial decisions,[4] is the validity of the so-called market-based causation theory upon which the majority of shareholder class actions are conducted. Properly understood, market based causation is not a special category of causation, rather it is just an example of indirect causation.[5] But this approach to causation depends on a theory that stock prices are a function of all material information about the company and its business, and that investors purchasing shares do so in reliance upon the market price representing the company's true value. This in turn means that it is unnecessary for investors to prove that they, individually, relied upon the misrepresentation which is alleged.

7 The degree to which equity markets are informationally efficient is disputed in the financial literature.[6] Properly analysing the financial implications of information disclosed to the market entails costs and there is a view that this precludes share prices from perfectly reflecting all material information.[7] Empirical analysis suggests that Australian equity markets are not informationally efficient with regard to either interest rates or exchange rates.[8] Interest and exchange rates are widely publicised macroeconomic variables that tend to have consistent impacts across industry sectors. If markets are informationally inefficient with respect to these variables, then that inefficiency is likely to be magnified with respect to company specific information contained in market disclosures.

8 If equity markets were fully efficient, then technical analysis predicated on the concept of using past price data to anticipate future price movements would be unprofitable. However, technical analysis remains a common practice amongst Australian financial professionals, suggesting that many in the industry continue to doubt market efficiency.

9 Owing to the high number of settlements in securities class actions, these issues have not (to our knowledge) been finally determined by an Australian Court. This is a significant issue given the rising number of shareholder class actions, the vast majority of which are conducted upon the assumption that market-based causation is an appropriate means by which to impute liability to a corporation. For this reason, we submit that any review should consider whether this is an appropriate methodology for causation to be established in shareholder class actions.

10 These considerations are particularly significant where companies face the prospect, not just of a single class action, but of multiple, competing class actions. Such conduct impacts upon the share price of a listed entity, and generally puts the company to significant expense (even if the competing class actions are stayed).

11 This observation is also in the context of rising costs of directors and officers liability insurance as noted by the Discussion Paper.[9] The pool of experienced Australian public company directors is finite. Decreased availability of protective insurance or greater exclusions within policy terms can

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[4] Although we note *HIH Insurance Limited (in liq)* (2016) 335 ALR 320; *Caason Investments Pty Ltd v Cao* [2015] FCAFC 94; *Grant-Taylor v Babcock & Brown Ltd (in liq)* (2015) 322 ALR 723.

[5] *Caason Investments Pty Ltd v Cao* [2015] FCAFC 94 at [93].

[6] Hatemi and Morgan, "An empirical analysis of the informational efficiency of Australian equity markets", (2009) 36 *Journal of Economic Studies* 437 at 437.

[7] Grossman and Stiglitz, "On the Impossibility of Informationally Efficient Markets", (1980) 70(3) *The American Economic Review* 393 at 405.

[8] Hatemi and Morgan, "An empirical analysis of the informational efficiency of Australian equity markets", (2009) 36 *Journal of Economic Studies* 437 at 437.

[9] Discussion Paper at [1.74].

lead to more personal exposure for directors and a greater reluctance to take on director roles. Whilst it may be argued that such a contraction of the insurance market will lead to more conservative and more compliant leadership styles to the benefit of shareholders, we suggest that the converse can occur – a diminishing group of experienced directors and reliance on lesser experienced people. A balance needs to be struck. Direct company indemnities may not be available and few will be wanting to risk exposing personal assets to the costs and uncertainty of class action litigation.

12 A further side effect of such class actions is an increased risk averse culture in publicly listed companies. In some respects that may be welcomed by shareholders, but in order to increase (or sometimes, even maintain) returns, an element of risk must be taken. The increase in class action risks can lead to a more risk-averse (and less entrepreneurial) approach to business. As we have commented, this may be welcome. However, it is often hard to see corporate growth (for the ultimate benefit of shareholders) if decision makers become more risk averse for fear of litigation.

2 Regulating Litigation Funders

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

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

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

2.1 KWM Response to Proposals 3-1 and 3-1

13 KWM supports amending the Corporations Act to require third-party litigation funders to obtain and maintain a "litigation funding licence" to operate in Australia. "Regulating third party litigation funding companies will safeguard consumers while preserving a valuable mechanism that facilitates access to justice."[10]

14 We are supportive of a funding licence which is bespoke to third-party litigation funders and sits outside of the AFSL regime but imposes comparable obligations. We submit that for the reasons outlined at paragraph 3.6 of the Discussion Paper, it is more preferable for the litigation funding licence to be a bespoke licence rather than simply require funders to obtain an AFSL. The current ASIC regulatory guides and supporting material, which have been developed over many years, were not designed with litigation funders in mind, and it would not always be appropriate to apply those guides to funders.

[10] PC – Access to Justice – 2014 – p.36

15 The terms of such a licence would need to be considered but they would, at least, cover the matters in Proposal 3 – 2. Capital adequacy requirements would have to be addressed.

16 ASIC is the appropriate body to regulate, audit, and administer the third party litigation funding licence, given that the obligations will generally mirror those which already are administered by ASIC in relation to AFSL holders. This is also appropriate given ASIC's role in monitoring compliance with the Corporations Act (which litigation funders are subject to currently and will continue to be). It is also appropriate that the regulator be a federal body rather than a State-based body (eg akin to the regulators of the legal profession). We note that ASIC is likely to have greater powers of enforcement following the Government's in principle agreement with the recommendations made by the ASIC Enforcement Review Taskforce. The Financial Services Royal Commission is also likely to result in further changes to the AFSL licensing process and those should be carried through to litigation funding licence holders.

17 KWM also agrees that an annual audit of litigation funders by ASIC is appropriate. Such an audit should specifically consider the exposure of the funder to adverse costs orders and whether the provisioning is sufficient. More details of the provisioning and number of matters should be included in any published accounts of publicly listed funders.

2.2 Question 3–1: What should be the minimum requirements for obtaining a litigation funding licence, in terms of the character and qualifications of responsible officers?

18 It has been our experience that some litigation funders have its key officers, such as directors, located in overseas jurisdictions and it has been very difficult to obtain any information about those persons or their suitability to conduct a litigation funding company. It also means that there are difficulties with enforcement. For example, in the case of *Allen Dodd v Shine Corporate Ltd*, the litigation funder's ultimate holding company (and the owner of all of its shares) was a company incorporated in Delaware. Searches performed revealed very little substantive information about the company save for the fact that it was incorporated in May 2017. Further searches revealed that two of the directors of the company were located in Texas with a third director located in Sydney. There was very limited publicly available information about the directors or the company. The litigation funder was not the owner of any registered property, or the lessees of any real property in Australia, or the grantor of any security interests registered on the Personal Property Securities Register. This caused the defendant to have serious concerns about the ability of the plaintiff and the litigation funder to have the financial means to meet an adverse costs order.

19 It is often the defendant that is put to the expense of investigating the directors and office holders by undertaking company and personal searches to determine the type of experience or qualifications they have to hold such a role in respect of a litigation funder, and the ability to enforce any judgment against them or ensure their compliance with Australian law.

20 Further, having minimum and transparent standards will also remove any suggestion that for example, a funder is merely a vehicle for a law firm to fund litigation.

21 The requirements set out by ASIC in its Licensing: Organisational Competence, Regulatory Guide 105 (December 2016) are appropriate for the financial aspects of the litigation funding licence holder. It is important that licence holders understand the requirements in respect of advertising and issues such as misleading and deceptive conduct, particularly in respect of advertisements and overtures to potential class members during the book build stage. We note here, for example, the case of *Morris v IMF Bentham Limited*,[11] where the conduct of the funder in the book build

[11] [2018] FCA 1009.

was alleged to have caused more damage to the company and its share price.[12] Having adequate training requirements may also assist funders in understanding their duties and obligations.

22 We do not suggest that the same fitness and character requirements be enforced as those for persons wishing to enter the legal profession, but there should be basic fitness and character requirements applicable to licence holders. Examples include an exclusions for persons who are undischarged bankrupts, or have convictions for offences against property or serious personal offences.

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

23 Currently extensive property and company searches have to be undertaken to determine whether a funder has any assets in Australia to meet an adverse costs order. These searches are undertaken at the expense of defendants. It is not uncommon for funders to be based overseas, and to appear to have no assets in the jurisdiction which are capable of meeting an adverse costs order.

24 Where a defendant is unable to determine if a funder has any assets, there is likely to be large amounts spent on obtaining security for costs. While it may be argued that security for costs is a sufficient safeguard, security for costs orders are difficult to obtain and the amounts ordered are often not commensurate with the actual costs of running the litigation. Security for costs, which places the burden on defendants, is not an adequate response and the burden should not be placed on defendants to establish that a funder has adequate funds. A minimum amount of capital adequacy should be required in order for the funder to operate in this market.

25 Additionally, it is impossible to know what a funder's commitments are, often across the world, and whether they can truly meet all of those commitments. Funders are also setting up smaller funding vehicles under the main funding name. In these cases it is difficult to determine the structure underlying these funds (whether by way of special purpose vehicle or otherwise) and their capital adequacy. Furthermore, in the case of special purpose vehicles, it is unclear whether these vehicles have any assets at all, or whether they are backed by the main funding company.

26 Minimum standards of capital adequacy also protect members of the class. It provides certainty that if the funder does fail, they will not be left with outstanding liabilities and that a funder has the capital to actually take a matter to trial if necessary. This may prevent the strong arming of class members by funders to settle early, perhaps for amounts which are not as favourable, because it does not have the capital to take to trial all the matters it has committed to fund.

27 This issue is very important. We have noted the funder and plaintiff law firm submissions to other consultative bodies, in which reference is made to the possibility of security for costs applications to protect defendants. Such a suggestion disguises the exposure that defendants really have in such circumstances.

28 Funders have offered undertakings to the Court in many matters as effective security for adverse costs orders. Behind that undertaking are often further funding arrangements with other funders (or, in some cases, US Hedge Funds) or the taking out of after the event costs insurance. These measures are not directly relevant to a defendant as ultimately there will be reliance on the funder's undertaking to the Court, but the defendant has no visibility on how many such undertakings have been given, which may diminish the veracity of the offered undertaking. Paragraph 3.60 of the Discussion Paper makes reference to the provisioning of IMF Bentham to

[12] We note that this case ultimately did not succeed due to the plaintiff lacking standing to bring the claim.

cover potential costs orders, being $14.5m in 2016 - 17. However, the exposure of IMF Bentham to adverse costs orders in all the matters in which it has proffered an undertaking is far greater than that sum. Paragraph 3.59 of the Discussion paper makes reference to ASIC's approach with AFSL holders who are required to hold capital reserves as a percentage of potential exposure of liability. We believe that the mooted bespoke license arrangements for funders should go further and identify, at a minimum, the number of matters the funder has offered security by way of an undertaking or guarantee or its like and a calculation of possible exposure. Already, publicly listed funders set out the global amount of damages pursued in cases in their accounts.. The other side of the equation, being the possible liability, should also be shown (without a requirement of listing individual matters).

29 Whilst more a matter for court control, the proliferation of offered insurance policies and poll deeds as security in matters is concerning. A defendant is put to the task of ultimately possibly having to chase recovery of such monies, often in overseas jurisdictions. The standard order for enforcement monies to be held in trust of $20,000 is wholly inadequate for such a recovery. Further, the defendant has no insight into what has been disclosed to this third party or insurer, such that if a time comes when the arrangement is called upon, they can find themselves caught up in further dispute, none of their own making.

30 We agree that the capital adequacy requirements proposed by the US Chamber Institute for Law Reform to the Victorian Law Reform Commission Inquiry into litigation funding seem to provide an appropriate level of protection. We would resist general exemptions for overseas entities but agree with the suggested control in relation to home jurisdictions. These issues should be explored further to ascertain what those controls may be for particular jurisdictions, as suggested at Paragraph 3.62 – 3.63 of the Discussion Paper.

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

31 The Australian Financial Complaints Authority (AFCA) replaced the Credit and Investments Ombudsman, Financial Ombudsman Service (FOS) and Superannuation Complaints Tribunal, and consideration needs to be given to whether this or another dispute mechanism is appropriate to deal with complaints.

32 We are yet to see the AFCA in operation (we understand that AFCA will be ready to receive and handle complaints from 1 November 2018) so it is difficult to assess at this stage whether this is the appropriate mechanism for handling disputes. At least in relation to FOS, the processes and decisions made were binding on members and we understand that a similar regime would apply in respect of members of AFCA. Our concerns with this are as follows:

a. The purpose of these schemes is to provide an alternative dispute resolution method, obviating the need for parties to go to court, which is appropriate for customers of banks and superannuation fund members who are usually individuals with complaints about matters which are individual to them and their particular circumstance, and which have no wide ranging implications. Indeed, in FOS for example, if a court action is instituted concurrently by the consumer, this removes FOS' jurisdiction to continue hearing the matter. This seems at odds with the wider context in which a complaint about a funder would be made. Presumably, it is group members who would be seeking to make a complaint about the funder and this would be about the terms of the funding agreement and the return to members. Any complaint by a group member necessarily has wider implications for the whole group and may impact the main litigation, which AFCA would not be equipped to deal with. This also raises the possibility of inconsistencies between AFCA's determination and the wider court proceeding. It seems to us, therefore, that it is the Court which is best equipped to deal with such complaints.

b. We also note that the processes and outcomes in this type of scheme are directed towards alternative dispute resolution and determinations which may not necessarily have a legal basis – this is not appropriate when considered in terms of a wider class action and large scale litigation which may be impacted by these. There is a possibility for inconsistency between determinations in respect of individual complaints.

c. It is also necessary to understand the kinds of complaints which could be directed to AFCA, but in the context of litigation funders any complaint that affects one group member is likely to affect all group members. Therefore, as AFCA is established to resolve single disputes, this may not be the appropriate body for litigation funding disputes.

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3 Conflict of Interests

> Proposal 4–1 If the licensing regime proposed by Proposal 3–1 is not adopted, third-party litigation funders operating in Australia should remain subject to the requirements of Australian Securities Investments Commission Regulatory Guide 248 and should be required to report annually to the regulator on their compliance with the requirement to implement adequate practices and procedures to manage conflicts of interest.
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> Proposal 4–2 If the licensing regime proposed by Proposal 3–1 is not adopted, 'law firm financing' and 'portfolio funding' should be included in the definition of a 'litigation scheme' in the Corporations Regulations 2001 (Cth).
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> Proposal 4–3 The Law Council of Australia should oversee the development of specialist accreditation for solicitors in class action law and practice. Accreditation should require ongoing education in relation to identifying and managing actual or perceived conflicts of interests and duties in class action proceedings.
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> Proposal 4–4 The Australian Solicitors' Conduct Rules should be amended to prohibit solicitors and law firms from having financial and other interests in a third party litigation funder that is funding the same matters in which the solicitor or law firm is acting.
>
> Proposal 4–5 The Australian Solicitors' Conduct Rules should be amended to require disclosure of third-party funding in any dispute resolution proceedings, including arbitral proceedings.
>
> Proposal 4–6 The Federal Court of Australia's Class Action Practice Note (GPN-CA) should be amended so that the first notices provided to potential class members by legal representatives are required to clearly describe the obligation of legal representatives and litigation funders to avoid and manage conflicts of interest, and to outline the details of any conflicts in that particular case.

3.1 KWM Response to Proposals 4-1 to 4-6

33 KWM agrees with Proposals 4-1 and 4-2. Our primary position, however, is that litigation funders should be required to obtain a bespoke licence, as discussed above.

34 As for Proposal 4-3, KWM does not consider it necessary for the Law Council of Australia to oversee the development of specialist accreditation for solicitors in class action law and practice. While ongoing ethical training on managing conflicts of interest is important, we do not consider that a specialist accreditation needs to be provided for this purpose. Rather, managing conflicts of interests in class action practices should be the norm when delivering continuing legal education in ethics. Those firms which specialise in class actions should be delivering this education in any event.

35 It is unclear but we have assumed that the intent of Proposal 4-3 is not to make accreditation a prerequisite to acting in a class action. If so, it is likely to significantly diminish the pool of lawyers. We would anticipate that regional lawyers would have difficulties with attendances necessary to obtain such accreditation.

36 We also agree with Proposals 4-4 and 4-6 and submit that these recommendations should be adopted. On this topic, some consideration should be given by the ALRC as to whether solicitors and litigation funders owe fiduciary duties to group members.[13] Fiduciary obligations (should they

[13] Simone Degeling and Michael Legg, "Fiduciary Obligations of Lawyers in Australian Class Actions: Conflicts between Duties" (2014) 37 *UNSW Law Journal* 914.

exist) may provide an additional layer of protection to group members in class actions involving litigation funders. We do not oppose Proposal 4-5 but are uncertain if it involves much benefit.. Virtually all relevant Court Rules require such disclosure. The breadth of the disputes anticipated by the Proposal is too wide. An International Arbitration involving say a Singaporean plaintiff and lawyers would present practical and ethical difficulties in enforcing such a rules, especially where the dispute resolution mechanism adopted by the parties is contractual.

37 As a general observation, the concern expressed by the Discussion paper is a real one. All defendant class action lawyers have participated in mediations or other settlement meetings where the driver is not the quantum of the class but the funder's expected rate of return. In many cases, once legal fees are reimbursed to a funder and its premium (usually ranging from 20 – 40%) is taken into account (usually on the gross not the net – less legal fees – basis), there is little left for the class. Hence, the need for large figure claims.

38 There is a genuine tension between the usual conduct of the plaintiff law firm/funder in a case and the defendants. Defendants, especially if insured need to work out a reasonable quantum and consider the percentage prospect of a loss. This usually leads to an insurer reserve and as a general rule, a settlement/trial decision below the reserve is encouraged and one above the reserve to be avoided. However, in order to have such an analysis, the defendant needs detail on causation issues and quantum. The plaintiffs, on the other hand, wish to avoid the costs and expense of such an exercise. They focus on liability (such as establishing a duty of care and breach) and pay little (or late) attention to causation and quantum. Hence, the difficult gap between the parties in seeking to resolve matters.

39 It is our experience that the class is often a forgotten participant in class actions. In a number of matters, there are representatives for various members/groups of the class on a "litigation committee" to participate in decisions. We suspect that, despite protestations to the contrary, it is still the funder that calls the shots in any settlement/trial discussions with such committees. Further, there is always the possibility that the same representatives come up across a number of different case committees for the same plaintiff law firm. Otherwise, if a low return is in the offing from a settlement, there is no reason why the class would not hold the funder to its commitment to fund until trial. Of course, there the potential for bluff, with the funder threatening to withdraw and the plaintiff law firm (usually legitimately) refusing to continue without guaranteed funding.

40 Perhaps as part of the initial Court certification process as mentioned above, the Court could appoint suitably qualified independent representatives, paid for by the funder, to sit on such committees to ensure there is a proper tester of issues. This would also hold the plaintiff law firm to account on possible conflict issues.

4 Commission Rates and Legal Fees

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

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

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

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

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

4.1 KWM Response to Proposal 5-1

41 KWM does not have any particular view on whether contingency fee arrangements should be permitted. However, we do note that to the extent that contingency fee arrangements are permitted, it will be utilised only by a small number of law firms with sufficiently strong balance sheets, particularly where contingency fees cannot be recovered in addition to professional fees for legal services charged on a time-cost basis and the ongoing responsibility for payment of the cost of disbursements. Unlike say in the personal injuries space, where matters are usually resolved within a year, the carrying of legal fees for possibly years in a class actions would be prohibitive for many firms. We could see an initial burst of enthusiasm but as the reality of the carrying costs hit home, we suspect many matters would be driven to settlement (especially if the solicitors are to advance the costs of disbursements, including possibly counsel and indemnify for adverse costs orders), which raises the spectre of conflicts of interest with the class.

42 If implemented, we would suggest that any firm that took on such matters be limited to say only three current matters. Any more and great financial pressure would be seen to bear on a firm, which must affect the lawyer's ability to avoid self-interest in a conflict situation.

43 Furthermore, KWM submits that consideration should be given to whether the matters taken on by a firm on such a basis should be identified. This information would be an important factor in determining whether or not a security for costs application was necessary. If a law firm disclosed it was acting on a contingency fee basis but was involved in two or three other major class actions with large costs exposures, it would be likely that a defendant would make a security for costs application (in the absence of disclosure of the firm's financial worth).

44 KWM generally supports the suggestion that court rules might be amended so that the court is able to treat the solicitor acting on a contingency fee basis as a funder for the purposes of ordering security for costs. Without this, a defendant is put to a considerable risk of having to defend an action with little to no certainty that, if successful, its costs can be recovered. We raise, for consideration, whether the Court should require such any potential contingency fee lawyer to

explain to the Court at an early stage, how the fees will be carried by it and how adverse costs orders will be dealt with by the lawyer.

45 Moreover, solicitors acting on a contingency fee basis should not be able to proffer adverse costs insurance as a means by which to avoid providing security for costs. This has occurred in some class actions involving litigation funders. While, in theory, the existence of insurance should allay any concerns about the plaintiffs' capacity to meet an adverse costs order, the reality is that the risk is shifted to the defendant, in circumstances where the plaintiffs may, due to an exclusion or otherwise, not be able to rely on the insurance policy in the event they are unsuccessful. In many instances, such policies are with overseas insurers, in circumstances where the defendant has no means of knowing whether the plaintiff has breached the policy or whether any other exclusions have been engaged. It should not be the case that a defendant who is ultimately successful has to start another claim to simply recover against a policy.

46 A final observation is that permitting solicitors to charge contingency fees may lead to the further commercialisation of the class action regime. One factor is the undue pressure on solicitors when conducting settlement negotiations. There must exist the possibility of a conflict of interest where a solicitor is negotiating not just for the settlement for the client but also for the amount from which its contingency fee will be deducted? Perhaps an independent court appointed class representative (or representatives if different sample groups) might help balance this risk.

47 This is an obvious area where we see the policy difficulty of dealing with different State layers of regulatory regimes and costs approaches.

4.2 KWM Response to Proposal 5-2

48 If contingency fees are to be allowed then the *Federal Court of Australia Act 1976* (Cth) should be amended to provide that contingency fee agreements in class action proceedings are permitted only with leave of the Court.

49 Any such amendment should include an express power for the Federal Court to (i) approve contingency fee arrangements, subject to conditions; or (ii) to reject, vary or set the contingency fee (whether charged as a percentage or otherwise). This is to avoid the situation which has arisen in the context of third-party litigation funding agreements,[14] and the attendant uncertainty of whether the Court can exercise its powers to vary the contingency fee arrangement where it would be in the interests of justice to do so.

4.3 KWM Response to Proposal 5-3

50 If contingency fees are to be allowed then the Federal Court should be given an express statutory power in Part IVA of the *Federal Court of Australia Act 1976* (Cth) to reject, vary or set the commission rate in third-party litigation funding agreements. This is consistent with the current authorities.[15] Further, KWM agrees that the power should also apply to contingency fee arrangements. However, whilst such an approach would ultimately identify an accepted "norm" for a commission rate, we suspect that leaving the control in fixing the commission with the Court may dissuade many from taking up such matters, unless the acceptable rate is sufficient to take into account the period of time for the carrying of the work in progress and disbursements together with the risk exposure to potential adverse costs.

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

51 KWM does not have any particular view on this issue.

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[14] See e.g. *Earglow Pty Ltd v Newcrest Mining Limited* [2016] FCA 1433.

[15] *Earglow Pty Ltd v Newcrest Mining Limited* [2016] FCA 1433.

4.5 Question 5–2: In addition to Proposals 5–1 and 5–2, should there be statutory limitations on contingency fee arrangements and commission rates, for example:

(a) Should contingency fee arrangements and commission rates also be subject to statutory caps that limit the proportion of income derived from settlement or judgment sums on a sliding scale, so that the larger the settlement or judgment sum the lower the fee or rate? or

(b) Should there be a statutory provision that provides, unless the Court otherwise orders, that the maximum proportion of fees and commissions paid from any one settlement or judgment sum is 49.9%?

52 In circumstances where, if accepted, the Court's approval would be required for contingency fee arrangements, and on the assumption that such a power includes the power to vary, reject, or set contingency fees, we see no reason to introduce specific statutory limitations. While we accept that "[t]he Court can only do so much",[16] even on the model suggested as an example, the Court will still be involved in the process. The Court will always need to consider the percentage of the contingency fee or commission and whether this is appropriate in the unique circumstances of the particular case in approving any settlement or trial decision. The Court is adequately equipped to deal with this situation.

53 The difficulty with statutory caps is that they can operate as the de-facto acceptable amount, which lawyers may consider being what they can charge up to in a matter. As there is already Court supervision on costs, we query the utility of a cap. A Judge is likely to be in the best position to closely examine any claim for costs that seems excessive in the circumstances.

54 The suggested maximum of 49.9% again could become an accepted figure. In some circumstances it could be too high. However, if the Court had the ultimate say in fixing the proportion, then there would be some oversight.

4.6 Question 5–3: Should any statutory cap for third-party litigation funders be set at the same proportional rate as for solicitors operating on a contingency fee basis, or would parity affect the viability of the third-party litigation funding model?

55 We see no reason why, if a statutory cap model were adopted, the rate at which it is set should differ depending on who is funding it. The query we would have is whether the funder would be able to avoid these measures by seeking to litigate in a State Supreme Court.

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

56 There are real difficulties with any self-funding model and our view is that such a model would be unnecessary if contingency fee arrangements are permitted. In such an environment, it is difficult to envision meritorious claims that would not otherwise be run by plaintiff law firms or under any other funding model. Presumably such cases might exist, for example, where the return to claimants is likely to be less than the total legal fees incurred. While a self-funding option may be viable here, it is not, in our view, appropriate for an action to be run where the legal fees incurred are greater than the likely amount to be obtained at settlement or judgment. Other difficult issues involve whether a defendant could obtain security for costs in such a case and how a board would determine which actions are "meritorious". These are matters which are often determined after the process of discovery, and after significant costs has been incurred. In our view, the introduction of contingency fees should encourage meritorious claims to be brought where it is viable to do so. Where the expected benefits are outweighed by the expected costs, there is a real question as to whether such actions should be encouraged.

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[16] *Inquiry into Class Action Proceedings and Third-Party Litigation Funders* at 94.

57 However, as an access to justice issue, we suspect that only the claims with high prospects would be accepted. Solicitors are unlikely to jeopardise their practice for claims with low prospects (but with great social justice value).

58 A fund such as that suggested would have to be carefully considered. We suspect that any funds allocated to it, would, in time, be dented by ongoing administration coats.

5 Competing Class Actions

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

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

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

5.1 KWM Response to Proposals 6-1 and 6-2

59 KWM supports Proposals 6-1 and 6-2.

60 The proposal to commence all class actions as open class actions, in particular, will go some way to reducing the instances of competing class actions. Coupled with the ability of the Court to make a common fund order, this eliminates the problem of free riders seeking to participate in the settlement without being involved in the class action prior to settlement.

61 One potential downside of this option is that, at present, such rates would only be fixed at the settlement stage of a matter. This may not be attractive to funders, to leave their business rate of return in the hands of the Court.

62 As for competing class actions, we only add two points. Firstly, the amendments should include a list of non-exhaustive factors that the Court may take into account in considering which proceeding will progress and which proceeding(s) need to be stayed. The factors identified by Lee J in *Perera v GetSwift Limited* [17][at [169] provide a useful starting point. Equally, the amendments should include factors which should not be taken into account, with one possibility being the order in which the proceedings were commenced.

63 The certification process we have mentioned can also deal with this threshold issue, in particular dealing with any contractual arrangements that particular class members may have with competing law firms. The Canadian model (referred to in Paragraphs 6.22 – 6.26 of the Discussion Paper) has some attraction in identifying the types of issues a Court could initially focus on in considering the certification application.

[17] [2018] FCA 732.

64 Secondly, we do not consider it necessary (as the Discussion Paper suggests)[18] to require potential claimants to consider and lodge a competing class action within a defined period of time. Our concern about this requirement is that it may lead plaintiff law firms to "rush" to court in order to be the first law firm to file. It is also inconsistent with existing limitation periods.[19] The Court's processes are adequately equipped to deal with applications to stay proceedings whenever they are brought.

65 Further, one of our main concerns about class actions is that they are often commenced in an environment of speed, rather than care for presenting a considered case. This often leads to a proliferation of interlocutory pleading disputes with the attendant cost and time delays.

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

66 An attraction of the proposal is to eliminate forum shopping, which has been illustrated by recent events in the various AMP class actions, so as to avoid disputes over which court is the appropriate forum for the class action and, in particular, the difficult issues arising where one court decides it should not transfer one of the proceedings to the other and vice-versa (we note that the AMP Class Action has not yet reached the stage where both Courts have refused to transfer the proceeding to each other).[20]

67 While it is desirable, in a federal system of government, for a litigant to be able to choose which court to commence proceedings in, it is not desirable for proceedings involving the exercise of federal jurisdiction over the same subject matter to be commenced in different courts. This only increases the difficulties associate with the phenomenon of competing class actions.

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[18] Discussion Paper at [6.46].

[19] As noted by Morabito, Vince, An Evidence-Based Approach to Class Action Reform in Australia: Competing Class Actions and Comparative Perspectives on the Volume of Class Action Litigation in Australia (July 11, 2018) at 20.

[20] See the judgments in *Wigmans v AMP Ltd* [2018] NSWSC 1045 and *Wileypark Pty Ltd v AMP Limited* [2018] FCA 1052.

6 Settlement Approval and Distribution

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

6.1 KWM response to Proposal 7-1

68 KWM supports the proposal to allow the Court to appoint a referee to assess the reasonableness of costs charged in a class action at the stage of settlement approval.

69 We only add that, in appropriate cases, the Court should also be able to appoint a referee or independent costs consultant to conduct periodic reviews of the reasonableness of legal costs, with only those costs assessed as reasonable costs being included for payment. This was the "novel suggestion" made in *Perera v GetSwift Limited*,[21] and has important practical benefits, chief of which is that it gives guidance to the parties at an early stage that the proceedings are being run in an appropriate manner, and it obviates the need for a costs assessor at the approval stage.

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

(a) How would a tender process be implemented?

(b) Who would decide the outcome of the tender process?

70 For the reasons canvassed in the Discussion Paper, there is a benefit to settlement sums being distributed by the lawyers acting for the plaintiffs in many cases. One solution is to have a scale of costs that legal practitioners can charge for administration the settlement distribution scheme, similar to say Insolvency Practitioners. In particular, legal practitioners should not be permitted to charge their usual commercial rates to administer the scheme.

71 A tender process would only be feasible if external parties such as Public or Private Trustee organisations expressed an interest in the role. Their interest is such a proposal should be canvassed. On one view the tender is only useful for the administration and distribution of settlement monies, rather than the assessment of claims. In that case, the assessment is done by the lawyer and handed to a more economic entity to distribute the funds. In such circumstances, we would query the need for a tender.

72 There is little attraction for the Court to determine a tender process. What if a challenge is made? It is better if the Court oversight is over the plaintiff lawyers who must satisfy the Court of the reasonableness of their approach.

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

73 In circumstances where court approval is required for class action settlements, KWM sees no reason why the terms of class action settlements should not be made public, without a Court order to the contrary. At the very least, the matters suggested by Professor Legg[22] have merit.

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[21] [2018] FCA 732 at [227].

[22] Discussion Paper at [7.39].

7 Regulatory Redress

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

7.1 KWM response to Proposal 8-1

74 KWM generally supports Proposal 8-1 for the Australian Government to consider establishing a federal collective redress scheme. A collective redress scheme has the ability to be more efficient and effective than litigation and would assist in addressing the issues of the large funds paid by plaintiffs and defendants to lawyers, litigation funder and/or insurers. However, we note that there would be considerable challenges in establishing such a scheme. As noted in the Discussion Paper, a federal collective redress scheme that can be adapted to a wide variety of industries would involve complex reform requiring the regulator, and those who are regulated, to support it. In light of this, KWM suggests that, at least initially, the redress scheme should be confined to securities class actions and should be regulated by an appropriate authority.

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

75 Any such federal collective redress scheme could be broadly based off the UK Consumer Rights Act 2015 (UK) (CRA) Scheme which permits businesses to submit a voluntary redress scheme to consumers. The CRA Scheme is designed as an alternative dispute resolution scheme and is intended to provide businesses with an option to compensate losses suffered by consumers.

76 In Australia, the scheme could be confined to securities class actions and should be regulated by an authority. Similar to the CRA Scheme in the UK, the redress scheme should be a voluntary system, whereby an application can be made by a single entity or on a group basis. An applicant would be required to appoint a chairperson (a senior lawyer or judge) who would assist in devising the terms of the scheme and deciding whether to recommend the scheme to the authority.

77 In considering the scheme, the authority should have the ability to make a penalty reduction in light of the infringing party's voluntary participation in redress, as is the case in the UK. As noted in the Discussion Paper one of the crucial issues with a redress scheme is how it is funded. Perhaps a set percentage of any sum awarded could be held to fund the ongoing work of the scheme.

78 Whilst such a scheme proposal has some merit in seeking to reduce the litigation cost and burden, it would have to be tightly managed. It would need early success to dissuade people from litigating outside it. Our experience with such schemes (such as the Gladstone Port compensation regime set up to fix compensation by fisherman affected by dredging) is that reference to income tax returns and realistic losses are often a deterrent to people lured by the prospect of higher returns through litigation.

79 We could see administrative scheme costs diminishing what is available. The terms of any distribution would require considerable work.

Yours faithfully

[redacted]

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