LAW FIRMS AUSTRALIA

Email 12 October 2018

The Hon. Justice S C Derrington
President
Australian Law Reform Commission
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class-actions@alrc.gov.au

Dear President

Inquiry into Class Action Proceedings and Third-Party Litigation Funders

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

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

The first LFA submission to the Inquiry was made on 6 August 2018 ('the first LFA submission'). This further submission addresses three issues raised in the Inquiry's Seminar Series Presentation Slides ('the Seminar Slides') published on 10 September 2018. Those issues are: the proposed review of the impact of continuous disclosure and misleading or deceptive conduct provisions (Proposal 1-1 in Discussion Paper 85); licensing of litigation funders (Proposal 3-1 in Discussion Paper 85), and; competing class actions (Proposal 6-1 in Discussion Paper 85).

1. Review of the impact of continuous disclosure and misleading or deceptive conduct provisions

1.1 The first LFA submission sets out the support for Proposal 1-1 from LFA, its member firms, and (in general) the clients of its members firms.

1.2 As indicated in the Seminar Slides, submissions in relation to this proposal were divided; broadly speaking, the proposed review was opposed by plaintiffs' law firms and litigation funders[1] and supported by defendants' law firms and insurers.

1.3 Generally, the submissions opposing the proposed review:

(a) argue that comparisons with legislative regimes in other jurisdictions are inappropriate,[2] or that if such comparisons are made, other jurisdictions' disclosure regimes are shown to

[1] However, it should be noted that the Association of Litigation Funders of Australia does not oppose the suggested review, but seeks and expansion to, or variation of, the terms of reference: Association of Litigation Funders of Australia, Submission No 58 to Australian Law Reform Commission, *Inquiry into Class Action Proceedings and Third-Party Litigation Funders*, August 2018, [1.1].

[2] See, eg, IMF Bentham Limited, Submission No 58 to Australian Law Reform Commission, *Inquiry into Class Action Proceedings and Third-Party Litigation Funders*, 6 August 2018, [2.2.3].

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be no less rigorous than that in Australia, or are in fact less rigorous to the relevant jurisdiction's detriment,[3]

(b) invoke the success of Australia's market integrity regime in improving compliance with market disclosure obligations,[4] and invoke incidences of misconduct (for example, as identified in the context of the current Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry) as a reason why the proposed review should not proceed,[5]

(c) reject concerns regarding the cost of directors and officers liability insurance ('D&O insurance') as anecdotal or the fault of insurers for under-pricing it originally, and[6]

(d) take issue with the impact on the investments of the defendant corporation at the time when that entity is being sued in a class action or having to contribute or pay any settlement.[7]

1.4 It is important to emphasise that the Inquiry has not proposed any amendments to the continuous disclosure regime or misleading or deceptive conduct provisions, nor any intention to recommend that the relevant provisions be 'watered down'. Proposal 1-1 is only that the impact of those provisions be reviewed, and the diversity of opinion on the impact of those provisions only serves to underscore why the necessity of the review.

1.5 A review could properly evaluate competing experiences, perspectives and observations from participants directly engaging with, or affected by, the relevant provisions and shareholder class actions. To argue these issues in the context of a proposal for such a review risks decisions being made by reference to partisan, and potentially selective, interpretations of the relevant facts and evidence.

Comparisons with other jurisdictions' market disclosure regimes

1.6 Concerns about whether, or how best, to compare Australia's regime to regimes in other jurisdictions, and a proper examination of the regimes in other jurisdictions, would best be undertaken during a review. Reliance on high-level comparators with overseas jurisdictions as apparent evidence for the success of Australia's continuous disclosure regime is misplaced, particularly as the proposed review offers the opportunity to consider these matters in depth and have an informed discussion as to whether any amendments to the current regime are justified.

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[3] See, eg, Australian Securities and Investment Commission ('ASIC'), Submission No 72 to Australian Law Reform Commission, *Inquiry into Class Action Proceedings and Third-Party Litigation Funders*, September 2018, [30]-[45]; Maurice Blackburn Lawyers, Submission No 37 to Australian Law Reform Commission, *Inquiry into Class Action Proceedings and Third-Party Litigation Funders*, July 2018, [1.8]-[1.17].

[4] See, eg, IMF Bentham Limited, above n 2, [2.5]-[2.9].

[5] See, eg, Maurice Blackburn Lawyers, above n 3, [1.18]-[1.20]; Therium Australia Limited, Submission No 19 to Australian Law Reform Commission, *Inquiry into Class Action Proceedings and Third-Party Litigation Funders*, 29 July 2018, 2-3; Slater & Gordon Lawyers, Submission No 54 to Australian Law Reform Commission, *Inquiry into Class Action Proceedings and Third-Party Litigation Funders*, August 2018, [1.7]-[1.8]; (paras 1.7-1.8), Bennelong Funds Management, Submission No 10 to Australian Law Reform Commission, *Inquiry into Class Action Proceedings and Third-Party Litigation Funders*, 26 July 2018, 1.

[6] See, eg, Maurice Blackburn Lawyers, above n 3, [1.29]-[1.34]; ASIC, above n 3, [59]; Phi Finney McDonald, Submission No 34 to Australian Law Reform Commission, *Inquiry into Class Action Proceedings and Third-Party Litigation Funders*, 30 July 2018, [2.8].

[7] See, eg, Maurice Blackburn Lawyers, above n 3, [1.21]-[1.28].

Perceived success of continuous disclosure laws

1.7 A significant number of the submissions opposing Proposal 1-1 mischaracterise the nature of the proposed review. As noted above, Proposal 1-1 does not recommend a review of the continuous disclosure and misleading or deceptive provisions per se, nor that they be 'watered down'; rather, it proposes a review of the legal and economic impact of those provisions.

1.8 LFA submits that the key issue is consideration of how private rights of compensation are being exercised through class actions in a specific and rapidly developing model of litigation that is costly to a corporate defendant, its shareholders, and its D&O insurers at the time of the litigation, and which absorbs a considerable amount of public resources.[8] It is not necessarily the case that advocates for a review would seek for that exercise of private rights to be abolished. Rather, having regard to a detailed examination of relevant rights, obligations, burdens, and the public interest, participants in any review may contend for the status quo to be maintained or for the exercise of such rights to be confined. Participants that favour confining private rights of compensation may:

(a) contend that relevant rights be confined to circumstances where there has been some fault element on the part of the corporate entity said not to have complied with the law, or

(b) advocate for the introduction of defences based on:

(i) reasonable beliefs of directors and officers,

(ii) due diligence, or

(iii) reasonable reliance on advisers.

1.9 Any review should also consider the increasing reliance on market-based causation by plaintiffs in shareholder class actions, including whether the concept encourages investors to read and consider corporate disclosures. This is especially so given that, as at the date of this submission, market-based causation has not been subject to a decision in a class action matter or by the High Court of Australia.[9] This is largely due to the propensity for class action matters to settle.

1.10 When ASX Listing Rule 3.1 and s 674 of the *Corporations Act 2001* (Cth) were enacted, reliance was generally contemplated as requiring actual knowledge of, and direct reliance upon, alleged misrepresentations or misleading conduct. The view may be taken that market-based causation is appropriate in a class actions context , but if so, it should be based on informed and rigorous analysis, rather than an understanding developed through shareholder class action mediations.

D&O insurance

1.11 As noted in the first LFA submission,[10] while insurers are perhaps best placed to address the availability and cost of D&O insurance, several clients of LFA members have reported increases

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[8] See, eg, LFA, Submission No 51 to Australian Law Reform Commission, *Inquiry into Class Action Proceedings and Third-Party Litigation Funders*, 6 August 2018, [1.1]-[1.17]; Insurance Council of Australia, Submission No 47 to Australian Law Reform Commission, *Inquiry into Class Action Proceedings and Third-Party Litigation Funders*, 3 August 2018, 2; Australian Institute of Company Directors, Submission No 35 to Australian Law Reform Commission, *Inquiry into Class Action Proceedings and Third-Party Litigation Funders*, 30 July 2018, 2-4; Zurich Australia Insurance Limited, Submission No 49 to Australian Law Reform Commission, *Inquiry into Class Action Proceedings and Third-Party Litigation Funders*, 6 August 2018, [5]-[9].

[9] It is noted that the issue has been considered by the Supreme Court of New South Wales in a liquidation, but not a class actions, matter: *HIH Insurance Limited (In Liquidation)* [2016] NSWSC 482.

[10] LFA, above n 8, [1.15].

in the price of D&O insurance (particularly primary and first excess layers) and/or a decrease in the availability of such cover.

1.12 A number of submissions raise arguments to diminish the concerns of corporates and insurers about the price and availability of D&O insurance. Principal amongst them is that D&O insurance has historically been 'under-priced',[11] and that as a result:

(a) shareholder rights should not be watered down to save the insurance industry from transitory losses or lower profits,[12] and

(b) lower premiums may be achieved by insured companies adopting more rigorous governance practices.[13]

1.13 There are a number of observations to make about under-pricing:

(a) First, if it is accepted that D&O insurance has been under-priced in the past, a dominant driver of those prices would have been the claims experience of the insurers. As the likelihood of shareholder class actions as increased in Australia, so too have insurance premiums.

(b) Secondly, comparisons between the Australian and United States insurance markets are unhelpful; the scale and claims experiences of different markets necessitate different pricing. Significantly, Side C insurance cover in the United States is almost entirely limited to entity defence costs coverage for securities class actions, and does not include liability indemnity cover (i.e. does not include cover for settlement or judgment sums).

(c) Thirdly, it is inaccurate to say that the relevant D&O coverage enlivened in class actions is 'historic' and affected by alleged under-pricing. D&O policies are claims-made; it is the policy in place when the claim is commenced that is enlivened, not the policy which was in place when the alleged misconduct took place. This generally means that policies taken out within the immediate past year will respond for shareholder class actions commenced today.

1.14 Most important is the fact that, regardless of any 'under-pricing', Side C D&O insurance has greatly increased in price. That is a cost that shareholders of companies have to bear unless, as is also a significant issue, insurers have withdrawn from providing cover in particular sectors or industries. That in itself creates disincentives for good directors to take board positions, thereby creating further risks of harm for corporates and their shareholders.

1.15 The proposed review of the impacts of continuous disclosure and misleading or deceptive conduct provisions provides an opportunity to appropriately consider the implications of these insurance issues, and balance them against any other relevant factors.

1.16 Finally, the proposition that lower premiums may be achieved by insured companies adopting more rigorous governance practices assumes a general deficiency in governance standards in the market. This has not been the experience of LFA member firms, and is certainly not demonstrated by corporate defendants agreeing to settlements in shareholder class actions. It is important to note that defendants often agree to settlements for a number of reasons unrelated to liability, including commercial and reputational factors.

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[11] IMF Bentham Limited, above n 2, [2.29]; Maurice Blackburn Lawyers, above n 3, [1.29] - [1.33].

[12] IMF Bentham Limited, above n 2, [2.31].

[13] Maurice Blackburn Lawyers, above n 3, [1.31].

Impact on shareholders at time of litigation

1.17 Most submissions that oppose Proposal 1-1 emphasise the benefit of shareholder class actions to shareholders eligible to participate in the actions, and overlook the impact on those shareholders who hold shares in the company as at the time of the class action. The financial impact on the latter group of shareholders is not difficult to ascertain: defence costs incurred while an insurance deductible is being eroded; increased D&O insurance premiums, and; contribution to settlements to the extent not covered by insurance. The share price of the relevant company is also likely to be reduced. In fact, the mere announcement of a shareholder class action, regardless of its legal merits, may harm a corporate defendant's share price.

1.18 Less tangibly, shareholders' interests may be affected by: diversion of corporate resources to defending and managing the class action; increased difficulty in the company attracting experienced and high quality directors, and potentially; inhibited decision-making caused by unjustified risk aversion. These issues are critical to the conduct of business in Australia and underscore the necessity for the review proposed by the Inquiry.

2. Licensing of litigation funders

2.1 Following the review of submissions on Discussion Paper 85 ('DP 85')[14], the Inquiry proposes that litigation funders be required to hold an Australian Financial Services Licence ('AFSL'). The Inquiry also proposes that an AFSL will not be required to provide funding to individual clients that are not consumers. This is to be contrasted to Proposal 3-1, which if adopted, would have required the establishment of a bespoke licensing regime for litigation funders.

2.2 The general proposal to require litigation funders to be licensed has been supported, or not opposed, by LFA, a number of litigation funders[15] and plaintiff law firms.[16] LFA also strongly supports the proposal for the licence to be an AFSL.

2.3 The need to license litigation funders arises from the important, and complex, relationships between funders, lawyers and litigants. Subjecting litigation funders to the AFSL regime would, together with other important outcomes: establish appropriate duties on litigation funders toward class members; require conflicts of interest to be managed appropriately; install capital adequacy requirements; require adequate risk management and dispute resolution systems to be in place; require litigation funders to be audited annually, and; establish breach notification procedures.

2.4 LFA agrees with the statement in DP 85 at [3.23] that a licence regime for litigation funders:

(a) has the potential to reduce the risk of financial loss to plaintiffs and defendants by reducing the risk that funders will be unable to meet their liabilities when due,

(b) can encourage compliance by litigation funders with their obligations given the risk of losing the right to participate in the market as litigation funders in the event of a breach of those obligations, and

(c) can potentially enhance the reputation of litigation funders and protect the integrity of the class action system by reducing any disreputable conduct.

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[14] Australian Law Reform Commission, *Inquiry into Class Action Proceedings and Third-Party Litigation Funders*, Discussion Paper 85 (2018).

[15] See, eg, IMF Bentham Limited, above n 2, [3.1]; Litigation Capital Management Limited, Submission No 30 to Australian Law Reform Commission, *Inquiry into Class Action Proceedings and Third-Party Litigation Funders*, July 2018, [10].

[16] See, eg, Phi Finney McDonald, above n 6, [3.1]; Maurice Blackburn Lawyers, above n 3, [3.3].

2.5 Notably, the licensing of litigation funders is resisted by the Australian Securities and Investment Commission ('ASIC'), primarily on the basis that:

(a) litigation funding should be regulated as a legal, and not a financial, service,[17] and

(b) ASIC is not a prudential regulator and the imposition of AFSL requirements would not necessarily mean that a litigation funder would be adequately capitalised to ensure it can meet adverse costs orders, continue to fund litigation or distribute funds to shareholders.[18]

2.6 ASIC's construction of litigation funding as a legal service would leave the responsibility for regulating funders to the Court 'through court rules and procedure, oversight and security for costs.'[19] There are two points to make in this regard:

(a) First, whilst the Court undoubtedly has an important role in the oversight of specific class actions matters, its remit does not extend to supervising the conduct of a litigation funding business generally. As is stated in DP 85 at [3.28]:

> *…courts are adjudicators and not investigators. The courts are regulating the funder through the prism of the funder's impact on the particular litigation before the court. The courts have limited capacity to view the totality of a funder's commitments to litigants at any given time and much less so over time. The courts cannot directly supervise litigation funders for the proper adherence to good governance and legal compliance more generally.*

The Court may determine that a security for costs order is appropriate in the circumstances of a particular class actions proceeding, and this will likely have implications for any litigation funding arrangement that is in place. However, that does not address the management of financial risks for the provision of litigation funding services more generally, nor any general duties that should be owed by a litigation funder to class members.

(b) Secondly, other jurisdictions have recognised the desirability of imposing capital adequacy requirements on litigation funders over and above security for costs orders. Litigation funders in Singapore must have a paid-up share capital of not less than S$5 million or not less than S$5 million in managed assets.[20] Albeit through a self-regulation model, litigation funders in the United Kingdom must maintain access to a minimum of £5 million of capital or such other amount as stipulated by the Association of Litigation Funders.[21]

2.7 The argument that the imposition of AFSL requirements would not necessarily mean that a litigation funder would be adequately capitalised to ensure it can meet adverse costs orders, continue to fund litigation or distribute funds to shareholders has been adequately addressed in DP 85. The Inquiry recognises that AFSL capital adequacy requirements 'are not designed to

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[17] ASIC, above n 3, [82].

[18] Ibid [65], [72].

[19] Ibid [76].

[20] *Civil Law (Third-Party Funding) Regulations 2017* (Singapore) r 4(1)(b).

[21] Code of Conduct for Litigation Funders, Civil Justice Council (United Kingdom), January 2018, cl 9.4.2.

eliminate the risk of failure',[22] and cites with approval the following statement of the Productivity Commission:[23]

> *An AFSL is not intended to prevent companies failing or becoming insolvent, nor does it guarantee compensation to consumers who suffer a loss. Nonetheless, the presence of the licence itself may provide adequate regulatory oversight to address the risk of disreputable operators.*

2.8 LFA submits that an AFSL is the appropriate vehicle through which to manage the financial risks of providing litigation funding services, the conflicts of interest that may arise in doing so, and the responsibilities of litigation funders to class members generally. It follows that ASIC is the appropriate regulator.

2.9 With respect to foreign litigation funders, the Inquiry proposed in DP 85 that litigation funders that are prudentially regulated overseas should be permitted to apply for an exemption from holding an Australian litigation funding licence.[24] Assuming that this view is still held in respect of the proposed requirement to hold an AFSL, LFA disagrees with the proposed exemption for the reasons set out at [2.22] and [2.23] of the first LFA submission. The views of IMF Bentham in this regard are also noted.[25]

2.10 Furthermore, LFA re-submits that foreign litigation funders be required, as a licence condition, to expressly:

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

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

2.11 Finally, LFA does not oppose the proposal that an AFSL not be required to provide funding to individual clients that are not consumers.

3. Management of competing class actions

Class closure orders

3.1 LFA supports the additional proposal in Recommendation 6-1 of the Seminar Slides that any class closure orders made during the course of the litigation be final, absent compelling reasons to suggest that it would be inefficient or otherwise antithetical to the interests of justice to do so. From a defendant perspective, this brings certainty and finality to the parties and promotes commercial resolution of the dispute.

Consolidation of claims and case management procedures

3.2 For the reasons outlined in the first LFA submission, LFA supports the additional proposal in Recommendation 6-2 and Recommendation 6-3.[26] However, it is noted that providing further case management procedures in the practice note should not be adopted as an alternative to the legislative amendments in Recommendation 6-2.

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[22] Australian Law Reform Commission, above n 14, [3.55].

[23] Australian Law Reform Commission, above n 14, [3.55] quoting Productivity Commission, *Access to Justice Arrangements* (Inquiry Report No 72, Vol 2, 2014) 632.

[24] Australian Law Reform Commission, above n 14, [3.62].

[25] IMF Bentham Limited, above n 2, [3.4].

[26] LFA, above n 8, [4.1]-[4.5].

3.3 A non-exhaustive, multifactorial set of criteria should be outlined in in Practice Note (GPN-CA) to determine the solicitors and funder that will have carriage of the class action. LFA generally agrees with the factors that have been identified in the Canadian context and the *GetSwift* decision[27] as the appropriate matters to be considered by the Court when determining carriage of the class action. Key factors from a defendant's perspective include:

(a) the funding arrangements,

(b) suitability of the proposed representative plaintiff to represent the claims of group members, and

(c) the extent to which the determination of the claim will achieve finality for all parties in relation to the underlying conduct at issue.

Leave to proceed

3.4 Following the review of submissions received in response to DP 85, the Inquiry released a supplementary note for consultation on 'leave to proceed'.[28]

3.5 LFA does not necessarily agree that a formal leave to proceed process is required. However, LFA supports efforts to ensure that Courts apply greater upfront scrutiny to the appropriateness of class action claims (not just the factors relevant to ss 33C and 33D of the *Federal Court of Australia Act 1976* (Cth)). LFA refers to observations in the Victorian Law Reform Commission's report on litigation funding and group proceedings relating to proposed reforms which strengthen the Court's case management powers, including by providing the Court with an own motion power to order that the proceeding no longer continue as a class action and that the representative plaintiff be substituted for another class member.[29]

Timetables for competing class actions

3.6 LFA also generally supports the Court setting timelines for lodging competing class actions in a particular proceeding.

3.7 Consistent with the approach adopted by Lee J in *GetSwift*[30] and favoured by the Inquiry in DP 85,[31] LFA agrees that a 'first in, best dressed' concept should not determine how the Court addresses competing class actions. Class action promoters should not be discouraged from properly scoping and investigating a potential class action claim before filing.

3.8 As the appropriate timeline for the filing of any competing claims will vary from case to case, LFA considers that this should be a matter of discretion for the Court at the first case management conference rather than prescribed in any practice note or legislation.

3.9 Nevertheless, guidance should be provided in Practice Note (GPN-CA) to ensure that the timeline set in each case achieves a balance between the need to allow sufficient time for potential class action claims to be thoroughly considered against the need to avoid causing

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[27] *Perera v GetSwift Limited* [2018] FCA 732, [306]-[324] ('*GetSwift*').

[28] Australian Law Reform Commission, Supplementary Note for Consultation: Leave to Proceed, 13 September 2018.

[29] Victorian Law Reform Commission, *Access to Justice – Litigation Funding and Group Proceedings*, (2018) [23].

[30] *GetSwift*, [170], [174]-[175].

[31] Australian Law Reform Commission, above n 14, [6.49]-[6.50].

undue delay to the class action(s) already on foot. LFA submits that relevant factors to be considered to determine an appropriate timeline, include:

(a) the complexity of the claim,

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

(c) the potential difficulty with identifying group members.

4. Conclusion

4.1 LFA appreciates the opportunity to provide a further submission to the Inquiry.

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

Yours faithfully

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