The Hon Justice Sarah Derrington

President

Australian Law Reform Commission

GPO Box 3708

Sydney NSW 2001

By email: class-actions@alrc.gov.au

20 August 2018

Dear Justice Derrington,

Inquiry into Class Action Proceedings and Third-Party Litigation Funders

The Australian Bar Association (ABA) is the peak body representing nearly 6000 barristers throughout Australia. Established in 1963, the ABA is committed to improving the legal profession and promoting the rule of law and the effective administration of justice.

The ABA appreciates the opportunity to respond to the Discussion Paper published by the Australian Law Reform Commission as part of its Inquiry into Class Action Proceedings and Third-Party Litigation Funders.

In preparation of the following submission, the ABA invited a Working Group of barristers to consider the proposals presented in the Discussion Paper. This submission presents both the recommendations which the ABA endorses and, on some points where there was the absence of a clear consensus, the weighted views of the Working Group are noted for consideration by the ALRC.

Yours sincerely

Noel Hutley SC

President

1. The ABA makes two general comments before responding to specific matters raised by the ALRC in the Discussion Paper.

2. First, the ABA considers that the existing class action regime generally operates efficiently and effectively and provides important access to justice whilst also acknowledging that at this point in the evolution of the regime it is appropriate to consider proposals of the kind raised by the ALRC in its Discussion Paper, the overall advantages and disadvantages of class actions, and possible reforms to strengthen and improve the operation, efficiency and fairness of the regime.

3. Second, the ABA observes that the ALRC's review is occurring at a time when there is significant activity in the class actions arena. In particular, the ALRC's review follows important reports from the Victorian Law Reform Commission (VLRC Report) and the Productivity Committee. It also occurs in circumstances where there are at least three highly significant cases relevant to the matters in the ALRC's Discussion Paper that are currently before intermediate appellate courts: *Botsman v Bolitho* (known as the *Banksia* proceedings), *Perera v GetSwift Ltd* and *Wileypark Pty Ltd v AMP Ltd* (the latter two of these cases involve competing class actions). In some cases, the ALRC may benefit from considering the outcomes of these appeals before recommending any particular reforms.

Introduction to the Inquiry

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

- the propensity for corporate entities to be the target of funded shareholder class actions in Australia;
- the value of the investments of shareholders of the corporate entity at the time when that entity is the target of the class action; and
- the availability and cost of directors and officers liability cover within the Australian market.

4. Proposal 1-1 raises complex and challenging issues of policy and law with a range of views. In the absence of consensus about this proposal, the ABA submits the following strongly held views for the consideration of the ALRC.

5. There is a view that a review of some kind is warranted. This comes with concern about the wider economic implications of the sharp increase in the incidence of shareholder class actions launched against listed entities in the last 10 years, along with the possible "chilling effect" that may have on the willingness of talented and qualified individuals serving as directors of publicly listed entities, particularly if it is affecting the availability of suitable and adequate directors and officers liability insurance. There is also concern that in many, but by no means all or even most, cases the commencement of shareholder class actions against listed entities may be predominantly motivated by third-party funders and lawyers seeking to secure extraordinary commercial gains. There is also recognition, however, that some of the reforms proposed by the ALRC are likely to address, at least in part, those concerns. And there is recognition that careful consideration would need to be given to the Terms of Reference to ensure it is fair and balanced and is not framed in "ideological" terms that implicitly fails to acknowledge the room for reasonable difference of opinion on this topic.

6. There is a view that the matters canvassed in the ALRC report do not provide a sufficient basis to warrant the review of the existing framework. This comes with concern that Proposal 1-1 did not directly arise from the Terms of Reference to the ALRC, and may distract from the principal focus of the Inquiry, which is whether there is adequate regulation of class action proceedings and third-party litigation funders operating within the current matrix of Commonwealth and State law. There is also concern that some public debate on the subject of securities class actions focusses upon the amounts derived by funders and lawyers from this form of litigation without sufficient regard to, *first*, the fact that these amounts are the price of enabling access to justice by many aggrieved shareholders (both retail and institutional) who claim to have been misled into purchasing securities to be compensated in respect of egregious conduct of corporations and their officers, and,

secondly, that where there are finite public resources available to prosecute corporate misconduct this kind of private litigation has public utility, including by reason of the deterrent effect it may have. Reservations about a review come with a particular concern that Proposal 1-1 is presently cast only in terms which focus upon the perceived costs associated with securities class actions, and not in more balanced terms which acknowledge perceived benefits.

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.

7. The ABA supports the introduction of a national licensing requirement for litigation funders broadly modelled on the Australian Financial Services Licences regime but with specific requirements as to capital adequacy and conflict management policies. It is not suggested such a regime need or should be overly onerous and prescriptive, but given the central role litigation funders play in the overall integrity of the class action regime, it is considered that the time has now come for the introduction of a formal licensing regime to ensure and supervise appropriate standards.

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 complaint dispute resolution system; and
- be audited annually.

8. The ABA refers to its answer to Proposal 3-1.

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?

9. If a licensing scheme is introduced, the ABA considers that it would be appropriate for the minimum requirements in terms of character and qualifications under such a scheme to be broadly similar to those that apply to AFSL holders.

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 appropriate buffers for cash flow.

10. In response to Question 3-2, it is noted that most of the ABA's Working Group were of the view that the current protection provided by security for costs is important, but is not a complete or fully satisfactory form of prudential protection from the risk of an insolvent or impecunious funder. Those members of the Working Group were also of the view that the AFSL financial requirements prescribed by ASIC should broadly apply to third-party litigation funders, and that an amount calculated as a percentage of potential exposure is preferable to a flat amount.

11. Other members of the ABA's Working Group were of the view that there is no need to reform the current system, and that in any given instance the relevant court can address these issues as part of its function in approving security for costs.

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

12. The ABA considers that the court's supervisory role in funded class actions should be sufficient without the need for third-party litigation funders to be required to join the Australian Financial Complaints Authority. However, it does not oppose that third-party litigation funders be required to join the Australian Financial Complaints Authority scheme.

Conflicts of Interest

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 the 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.

13. Whilst the ABA considers that third-party litigation funders should remain subject to the requirements of ASIC *Regulatory Guide 248* and should be required to report annually to the regulator, it agrees with the views expressed by others that hitherto ASIC *Regulatory Guide 248* has been ineffective in regulating the behaviour of litigation funders.

14. The ABA also shares the concerns of the ALRC and others as to the prevalence of inherent conflicts of interest that threaten the overall integrity of the class action regime. An acute example of conflicts, noted by others, that can and has emerged is when lawyers acting for the representatives of the class action are put in the position of in effect acting as the advocate for the funder in making submissions in favour of often very significant payments to the funder or that the court lacks the power to reduce funding commission rates even if it is of the view it is not fair and reasonable to group members.

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).

15. In principle, the ABA agrees that the definition of "litigation scheme" in the *Corporations Regulations 2001* (Cth) should be reasonably adapted so as to capture every possible permutation of a third-party litigation funding agreement, whilst ensuring that the definition is not so broad that it has unintended consequences.

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.

16. The ABA supports the proposal that an Australian Solicitors' Conduct Rules should be amended in this manner. The need for such an amendment is made plain by *Bolitho v Banksia Securities Limited* [2014] VSC 582 where the solicitor acting for a party supported by a funder had a financial stake in that funder and the Court was therefore concerned that the solicitor would not bring, or not be seen to bring, the necessary objectivity to the discharge of the solicitor's professional duties to the

client. In light of the facts in that case, the ABA may consider amendments to the National Barristers' Conduct Rules.

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.

17. In response to Proposal 4-5, it is noted that most members of the ABA Working Group held reservations about the amendment of the Australian Solicitors' Conduct Rules to require disclosure of third-party funding in "any dispute resolution proceedings". Those members of the ABA Working Group were of the view that questions of disclosure of funding agreements outside of the class action context be left to the discretion of the relevant court or arbitral tribunal in the circumstances, although it would be desirable for the court's rules to be amended so as to require a court, at an early stage of the proceeding, to give consideration as to whether disclosure of third-party funding is appropriate in any given instance.

18. Other members of the ABA Working Group were of the view that the Australian Solicitors' Conduct Rules should be amended in the manner proposed: a fundamental policy underpinning the regulation of litigation funding should be absolute transparency of its existence and of the terms of all litigation funding arrangements.

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.

19. The ABA generally agrees with this proposal. However, the proposal should be implemented in a plain English manner that is clear, succinct and prominent so that there is no risk of the information being lost in all of the other information that must be provided to potential class members.

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.

20. This is a difficult issue which requires deeper consideration and debate and was recognised as such by all members of the ABA Working Group. Whilst it is recognised that reasonable arguments in favour of the introduction of contingency fees in at least some cases have been advanced, the introduction of contingency fees would represent such a fundamental shift in Australian legal culture and practice and that such a step that should not be taken lightly and without the most anxious consideration, consultation and analysis. Most members of the ABA Working Group were not persuaded that the benefits of introducing contingency fees, even in limited circumstances, outweigh the potentially irreversible and adverse consequences to the structural integrity of the legal profession.

21. Other members of the ABA Working Group were of the view that further consideration and debate is required and that such consideration ought encompass a comparative analysis of whether the introduction of similar contingency fee arrangements in other jurisdictions with which Australia has common ancestry (such as the United Kingdom) has in fact led to unwelcome consequences.

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

22. Assuming that contingency fees were introduced, the ABA agrees that it is essential for appropriate protections and safeguards to be established to avoid excesses and manage potential conflict. This would include 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.

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?

23. In response to Question 5-1, it is noted that most members of the ABA Working Group were of view that the prohibition on contingency fees should remain with respect to certain specified class actions should the prohibition on contingency be lifted. Other members of the ABA Working Group were of the view that should the prohibition on contingency fees be lifted, it should be lifted across the board without exception.

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

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

24. There is a preliminary issue as to whether the Federal Court does presently have the power under ss 33V and 33ZF of the *Federal Court of Australia Act 1976* (Cth) to reject, vary or set the commission rate in the litigation funding agreement, whilst still approving the overall settlement sum.

25. It is plain that this issue has not been authoritatively determined by an appellate court. There appears to be a division of opinion in the decisions at first instance. There is a question as to whether the courts have such a power. A majority of the ABA Working Group holds the view that the position under existing law is therefore not beyond doubt.

26. That being so, most of the ABA Working Group agreed with the recommendation made by the VLRC in the VLRC Report, that (a) the court should have such a power

given the potential size and significance of these deductions from the settlement of judgment sum available for distribution to group members, and (b) the existing doubt in that regard should be removed by the conferral of an express statutory power, for the avoidance of any doubt, along the lines proposed.

27. It is noted however that this issue of power, or related issues of power, has been squarely raised for determination by the Victorian Court of Appeal in the part-heard appeal from *Re Banksia Securities Ltd (No 2)* [2018] VSC 47.

28. It is also noted that the "commission rate" is not the only contractual integer within the funding agreement that determines the funder's prima facie contractual entitlement. There are other integers such as the reference amount (settlement sum) that can provoke debate, especially where there are "competing" claims by other plaintiffs against the same defendant and there is a global settlement. Accordingly, the express statutory power contemplated should include the words after "commission rate" as follows: "or such other term of the funding agreement relevant to the calculation of the funder's entitlement to payments under the funding agreement".

29. Some members of the ABA Working Group expressed a concern that the courts may be ill-equipped to act as a price regulator in circumstances where the prices sought to be charged by third-party litigation funders may be a function not only of proportionality of risk and return in a particular case, but also of particular litigation funders' decisions as to whether or not to approach their business on a portfolio basis. In other words, apparently high commission rates in one particular case may be a function of litigation funders being prepared to spread their risk across multiple cases of varying strengths, and it would be undesirable for courts which would necessarily be required to regulate commission rates on a case-by-case basis to take the view that a particular commission is too high in absolute terms without recognizing that lowering it may affect the ability or willingness of litigation funders to fund other smaller, or more difficult cases within their portfolio, with a general adverse effect on overall access to justice.

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:

- 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
- 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%?

30. The ABA considers that the imposition statutory caps and limitations would go too far and are unnecessary. The present model of court supervision and approval is appropriate and sufficient to guard against manifestly excessive or disproportionate payments to the funder out of the settlement or judgment sum.

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?

31. The ABA agrees that if statutory caps are to be imposed, they should be imposed equally on solicitors and litigation funders.

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.

32. The ABA recognises this is a difficult issue but submits that insofar as competing class actions present a problem, the appropriate approach is to encourage courts to deal with such problems by active case management within their existing broad suite of powers express and implied under Part IVA.

33. In light of the pending appeals from the decisions of *Perera v GetSwift Ltd* and *Wileypark Pty Ltd v AMP Ltd*, it may be prudent to at least wait for those decisions to be handed down before giving this proposal fuller consideration.

34. It is noted that the issue may not be confined to competing class actions but also to circumstances where there is a class action against a particular defendant and a parallel proceeding also commenced against that defendant for related loss and damage by receivers, liquidators and special purpose receivers on behalf of the company and its creditors/shareholders (being broadly the same constituency as the members of the class).

35. The ABA observes that in the various submissions made to the ALRC, there can be said to be a loose consensus that the allowance of common fund orders has created, or at least contributed, to this problem. The ABA agrees the effect of common fund orders, instead of funding equalisation orders, requires further consideration. Any such consideration should take into account the undesirability of encouraging races to the courthouse, and the correlative risk of truncation of prudent investigation of claims (both of which have been exacerbated by the current trend of filing open class actions and seeking common fund orders).

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.

36. The ABA's response to this Proposal would be contingent on the approach taken to Proposal 6-1. In any event, the ABA suggests consideration should be given by the Federal Court as to whether any amendments to the Practice Note are desirable.

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?

37. Conferring exclusive jurisdiction on the Federal Court of Australia with respect to the matters mentioned in this question would be a significant step to take. Prior to such

a reform being implemented, very careful consideration would need to be given to the merits of such an approach, including potential constitutional issues, and any unintended consequences that might flow from the grant of such exclusive jurisdiction. The ABA is aware that the Full Federal Court is presently considering, in the *AMP* cases, whether or not State laws are competent to suspend certain Commonwealth limitation periods – an issue which may be relevant to this question. The ABA is not presently convinced that it is necessary or desirable for the Federal Court to be given exclusive jurisdiction with respect to the mentioned matters.

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.

38. The ABA supports the ALRC's proposal in respect of the appointment by the court of truly independent costs referees to assess the reasonableness of costs charged in a class action prior to settlement approval. It is also suggested that the effectiveness of such a regime might be improved if the costs assessor is appointed at an early stage and is able to perform that role throughout the matter based upon his or her ongoing familiarity with the matter. The ABA is, however, mindful that in some cases (especially smaller cases) the cost of undertaking that exercise may prove to be a burden on the advancement of claims, and considers that the court should retain discretion as to what is the most appropriate means of ensuring that only reasonable costs are charged to group members.

39. It is also noted that it would be desirable for the appointment of a costs assessor and the appointment of contradictors/amicus curiae to be further addressed in a common practice note between the Federal Court and State Supreme Courts. In many, but not all, cases the appointment of a special referee or contradictor/amicus curiae in relation to all or some issues may be appropriate but the court should retain the discretion to decide whether this is appropriate in any given instance, based on the circumstances of each case.

40. The ABA observes that it may be that this practice is evolving to the point whereby the usual or presumptive position is that a contradictor/amicus curiae is to be appointed and a special referee in relation to costs is also to be appointed, which could be noted or addressed in the Practice Note.

Question 7-1 Should settlement administration be the subject of a tender process? If so:
- How would a tender process be implemented?
- Who would decide the outcome of the tender process?

41. The ABA does not consider that reform along these lines is warranted.

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?

42. The ABA has the impression that the courts are adequately addressing this issue so far on a case-by-case basis. In doing so, the courts have been mindful of the principles of open justice, the desirability of group members knowing as much about the settlement as possible and legitimate reasons for the suppression of at least some aspects of the terms of settlement in some cases. The ABA does not consider that legislative reform is necessary or desirable.

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.

43. The ABA supports this proposal in principle.

We thank you for the opportunity to make these observations and will happily discuss these matters with the Commission. Please contact the ABA's CEO Cindy Penrose, if you should so wish.

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This submission was informed by the views of an ABA Working Group:

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