

## **IMF BENTHAM LIMITED**

### ***Inquiry into Class Action Proceedings and Third-Party Litigation Funders***

### **SUBMISSION TO THE AUSTRALIAN LAW REFORM COMMISSION**

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## 1. Introduction

- 1.1 Litigation funding is the lifeblood of much of Australia's class action litigation.<sup>1</sup> Without litigation funding, for many cases the core function of the class action regime, namely providing mass justice for mass civil wrongs, would not be realised. It is a practical solution to the considerable costs and risks faced by applicants in representative proceedings. For thousands of Australians, litigation funders have turned Part IVA's promise of access to justice into a practical reality.
- 1.2 Prior to the advent of third party litigation funding the class representative faced the prospect of having to pay all of the adverse costs if the action was unsuccessful. Other class members were (and are) immune from any Court order requiring payment of such costs. This led to the risk of law firms appointing indigent "straw reps" who, being unable to pay adverse cost orders, were prepared to become bankrupt. This was unfair on respondents and stood to bring class actions into disrepute.
- 1.3 Funding has evened the playing field between claimants and defendants and been instrumental in the recovery of hundreds of millions of dollars in compensation. Funded class actions have augmented regulators' enforcement of Australia's continuous disclosure, misleading and deceptive conduct, competition and other laws introduced for the protection of the public and have had an undoubted deterrent effect on potential wrongdoers. All this has been achieved without an "explosion" in class action litigation.<sup>2</sup>
- 1.4 IMF Bentham Limited (**IMF Bentham**) is one of the world's pioneers of commercial litigation funding and is itself a leading global funder. IMF Bentham is pleased to make these submissions in response to the Australian Law Reform Commission's Inquiry into Class Action Proceedings and Third-Party Litigation Funders (**Inquiry**).
- 1.5 The Inquiry comes at an eventful juncture in the development of Australia's class action jurisprudence and litigation funding market. Policymakers and the Courts are grappling with competing class actions and common fund orders, increasing competition in the litigation funding market with more involvement of foreign-based litigation funders and a goal of reducing costs and increasing returns to successful group members. All this is occurring against a backdrop of rising pressure from the corporate and insurance sectors to rein in an effective private enforcement regime. In the other direction, there are renewed calls from plaintiff lawyers for the introduction of contingency fees.

### Setting the Scene

- 1.6 When assessing the ALRC's proposals, IMF Bentham believes that regard should be had to the system for funded class actions which developed in Australia over the last 15 years or so before the recent advent of common fund orders and 'open' class litigation.
- 1.7 That system of 'closed' class actions was based on the law as it now stands which permits class actions to be constituted by "all or some" of the class members. Closed classes should be permitted to continue and should not be stayed simply on the basis that they do not make

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<sup>1</sup> Law Council of Australia and Federal Court of Australia, *Case Management Handbook* (December 2014), 93 ("In many senses, litigation funding has proven to be the life-blood of much of Australia's representative proceeding litigation at federal and state level").

<sup>2</sup> The 'myth' that Australia has the highest per capita rate of class action litigation outside of the United States has been debunked by Professor Vince Morabito in his latest empirical report: V Morabito, *Competing class actions and comparative perspectives on the volume of class action litigation in Australia* (Monash University, 11 July 2018), 8-11.

claims on behalf of an open class.

- 1.8 In IMF Bentham's submission, that system served applicants and group members well. The benefits extended to defendants, whose costs were underwritten in the event claims against them were lost. The civil justice system was served by funders' resources supporting the efficient and skilled prosecution of complex litigation.
- 1.9 Most of the resolved funded class actions to date have resulted in material returns to class members. In those class actions funded by IMF Bentham, about 60% of all funds have been paid out to class members. These returns cannot be dismissed as derisory; they are important to the claimants concerned and generally would not have been achieved without funding. The use of closed classes and the conduct of bookbuilds by funders meant that only claims the victims themselves felt strongly about were initiated. Claims were generally carefully investigated by funders, with only proceedings for strong and meritorious claims being funded.<sup>3</sup> The claimants chose the lawyers and funders they wished to take their actions forward.
- 1.10 Litigants had direct contractual relationships with the funder and their lawyers. Their claims were known and well-managed. They knew the terms on which legal services and funding were being provided to them and they were kept apprised of developments in their litigation. Unfunded group members invariably had the opportunity to join an action prior to mediation or settlement discussions (when the class was opened and then closed in order to provide respondents with finality). Mechanisms were developed to ensure fairness in allocating costs across funded and non-funded group members.<sup>4</sup> Lawyers' fiduciary obligations to applicants and group members were paramount. Government maintained a light touch regulatory regime for funders, while lawyers and funders remained subject to the Court's ongoing supervision, including when settlement approval was sought.
- 1.11 While competing class actions, the use of common fund orders, increasing competition amongst funders and high costs are currently challenging the class action system, in IMF Bentham's respectful submission, the system itself is fundamentally sound and any change to it should be incremental and well thought through. The ALRC needs to be satisfied that any proposed change is both necessary and desirable and will result in a net benefit to group members, the courts, and other affected parties. Reform which disincentivises the funding of class actions or types of class actions is unlikely to be in potential group members' best interests.

#### Summary of IMF Bentham's principal submissions

- 1.12 IMF Bentham's principal submissions are:
  - 1.12.1 there is no need for an inquiry into the continuous disclosure laws and the statutory prohibitions on misleading and deceptive conduct. Further, if there is to be any change in these laws, it should not be to water them down but rather steps should be taken to make their enforcement, via representative proceedings, less costly and more efficient;
  - 1.12.2 IMF Bentham supports the proposal that third party litigation funders be licensed. Given the central role third-party litigation funders play in financing representative

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<sup>3</sup> Although litigation commenced by entities associated with Mr Mark Elliott faced a number of procedural hurdles with some proceedings stayed as an abuse of process: see e.g. *Melbourne City Investments Pty Ltd v Myer Holdings Ltd* [2017] VSCA 187.

<sup>4</sup> Known as 'funding equalisation orders' which operate "to redistribute the additional amounts received 'in hand' by unfunded class members *pro rata* across the class as a whole": *Perera v GetSwift Limited* [2018] FCA 732, [25].

proceedings, funders operating in Australia should be required to have a permanent presence in this country, hold a tailor-made litigation funding licence, be subject to regulation by the Australian Securities and Investments Commission and join the Australian Financial Complaints Authority scheme;

- 1.12.3 IMF Bentham supports the proposals in relation to conflicts of interest, including those concerning disclosure. Solicitors and counsel acting in a matter should not have any interest, direct or indirect, in any third party litigation funder, domestic or foreign, that is providing funding for a matter in which they act, and should fully disclose all relationships they have or had with the funder, so as to enforce as complete a separation between the funded claimants' legal representatives and the funder as possible. Reciprocal arrangements whereby lawyer A funds the cases of lawyer B and *vice versa* should not be permitted;
- 1.12.4 the case for introducing contingency fees has not been made out and the ALRC ought not recommend their introduction;
- 1.12.5 while recognising that the Federal Court may set a funder's commission rate as part of a common fund order and may reject a class action settlement for approval on the ground that the commission rate makes the proposed settlement unfair or unreasonable to group members, the Federal Court should not be given express statutory power to reject, vary or set the commission rate in litigation funding agreements (or indeed any other aspect of the agreement) and there should be no statutory caps on commission rates. Commission rates are best set by negotiation in the existing, competitive, funding market. Group members are adequately protected by existing laws such as those concerning unconscionable conduct and unfair contracts and existing regulations relating to conflicts of interest (and by the funder licensing proposals discussed elsewhere in this submission);
- 1.12.6 a 'one size fits all' approach to the management of competing class actions, should not be preferred (by the Courts or Parliament) to a case-by-case approach. This approach enables each set of competing class actions to be managed as best suits the individual circumstances of the parties involved;
- 1.12.7 IMF Bentham does not support removing the option for applicants to bring representative proceedings on a 'closed class' basis. Further, the *Corporations Act 2001* (Cth) should be amended to permit access to, and use of, a respondent's share register for the purpose of identifying and notifying class members of the potential class action;
- 1.12.8 IMF Bentham does not support granting the Federal Court exclusive jurisdiction over shareholder class actions, the proposed 'class action reinvestment fund', or a federal collective redress scheme (given the current regime already provides avenues for companies to provide redress); and
- 1.12.9 IMF Bentham supports the proposal to subject settlement administration to a tender process.

## 2. Continuous Disclosure and Shareholder Class Actions

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

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

2.1 Proposal 1-1, which appears in the introduction to the Discussion Paper under the heading “Shareholder class actions”, has been widely interpreted as calling for a “*watering down*” of the investor protection laws as a means of quenching an “*explosion*” in shareholder class actions in Australia.<sup>5</sup>

2.2 IMF Bentham respectfully submits that Proposal 1-1 should *not* be included in the ALRC’s final report to government because:

2.2.1 it is outside the ALRC’s Terms of Reference which are directed to “*whether and to what extent class action proceedings and third party litigation funders should be subject to Commonwealth regulation*” with the Terms of Reference making no reference to any substantive law enforced through class action litigation;<sup>6</sup>

2.2.2 the investor protection laws are fundamental to the integrity of Australian securities markets<sup>7</sup> through the promotion of investor confidence, the accountability of listed entities and the avoidance of market manipulation and insider trading,<sup>8</sup> such that any watering down of these provisions or their effective enforcement would be a serious and retrograde step;

2.2.3 it is dangerous to compare other laws in other countries without a full consideration of the factual context in which they operate, and without considering how these laws have been interpreted and applied;

<sup>5</sup> P Durkin and M Pelly, ‘CFOs back review on class actions’, *The Australian Financial Review* (Sydney), 19 June 2018, 2 and M Legg, ‘Watering down laws may not stem flood of class actions’, *The Australian Financial Review* (Sydney), 21 June 2018, 47.

<sup>6</sup> The ALRC fairly concedes “*Such a review . . . is beyond the scope of the ALRC’s current terms of reference*”: Discussion Paper, [1.82].

<sup>7</sup> Explanatory Memorandum to the CLERP 9 Act:

“. . . *continuous disclosure is fundamental to the integrity of Australian securities markets. It is important that all investors should have equal and timely access to price sensitive information released by disclosing entities. Inadequate disclosure has the potential to discourage investor participation in securities markets. This in turn could reduce the liquidity of these markets and hence the efficiency of the price discovery process.*”

<sup>8</sup> *James Hardie Industries NV v Australian Securities and Investments Commission* [2010] NSWCA 332 at [355]: “*The continuous disclosure regime, contained in s 674 and the Listing Rules, is designed to enhance the integrity and efficiency of Australian capital markets by ensuring that the market is fully informed. The timely disclosure of market sensitive information is essential to maintaining and increasing the confidence of investors in Australian markets, and improving the accountability of company management. It is also integral to minimising incidences of insider trading and other market distortions.*”

- 2.2.4 it was envisaged by the architects of Part IVA of the *Federal Court of Australia Act 1976* (Cth) (**FCA**), including the ALRC itself, that the class action procedure would be utilised by aggrieved investors and shareholders in seeking compensation for breaches of their statutory rights and that is precisely what has occurred<sup>9</sup>;
- 2.2.5 there has been no “explosion” in class actions in Australia, whether initiated by shareholders or otherwise (there is an issue with ‘competing’ class actions, which is being dealt with by the Courts and is discussed elsewhere in this submission). Nevertheless, as shareholder claims commenced from an almost zero base 15 years ago, it is not surprising there has been an increase in such claims over time;
- 2.2.6 the number of corporate entities which have been the subject of shareholder class actions is minuscule relative to the total number of listed entities on the ASX;<sup>10</sup>
- 2.2.7 any concerns the ALRC may have about “*unintended adverse consequences caused by the existing framework of the Australian statutory regime*” are misplaced;<sup>11</sup> and
- 2.2.8 saving the insurance industry from its apparent failure to properly price D&O cover in Australia since, at least, 2011<sup>12</sup> (if not earlier) is not a compelling reason to review this country’s cornerstone laws for promoting investor protection and market confidence.
- 2.3 In light of the importance of these laws, if the ALRC decides to recommend such a review and if Government is prepared to commission it, IMF Bentham submits the review:
- 2.3.1 be conducted with input from all affected stakeholders, including the ASX, listed companies, the Australian Institute of Company Directors, institutional investors, the Australian Shareholders Association, academics, plaintiff and defendant law firms, litigation funders and insurers;
- 2.3.2 specifically consider ways in which the enforcement of the continuous disclosure laws through private actions for damages can be made more efficient and less costly, as IMF Bentham submits below; and
- 2.3.3 pay close attention to the wider economic importance to Australia of effective, enforceable continuous disclosure laws and prohibitions of misleading and deceptive conduct by listed entities and not weaken those laws because of transitory issues in the insurance industry.
- 2.4 IMF Bentham expands on these submissions below.

### **The importance of the investor protection laws**

- 2.5 Effective and enforceable disclosure obligations are one of the four foundations comprising Australia’s securities and financial services regulation.<sup>13</sup> Chief among the disclosure laws are

<sup>9</sup> M Welsh and V Morabito, ‘Public v Private Enforcement of Securities Laws: An Australian Empirical Study’ (2014) 14 *Journal of Corporate Law Studies* 39, 42 – 43.

<sup>10</sup> IMF Bentham estimates, based on the empirical work of Professor Morabito, that in the last 5 years class actions have been filed against 1.1% of companies listed on the ASX (27/2,400 \* 100).

<sup>11</sup> Discussion Paper, n 73, discussed further below.

<sup>12</sup> XL Catlin and Wotton+Kearney, ‘Show me the money!’ (White Paper, September 2017), 12 (“*Estimating the size of the Australian D&O market is a little tricky*”), 15 (“*Chronic under-pricing of ABC D&O business by insurers since at least 2011*”).

<sup>13</sup> In addition to regulating the disclosure of information to investors, the other specific areas of regulation cover (a) the establishment and conduct of securities markets, (b) the operation of clearing and settlement facilities and (c) the licensing and conduct of intermediaries: R Baxt, A Black and P Hanrahan, *Securities and Financial Services Law* (9<sup>th</sup> ed, 2017), [1.13].

- those mandating continuous disclosure by listed entities<sup>14</sup> backed up by the statutory prohibitions on corporations and others engaging in misleading and deceptive conduct.<sup>15</sup>
- 2.6 The current continuous disclosure regime was introduced in 1994<sup>16</sup> and has been widened<sup>17</sup> and amended to improve enforcement.<sup>18</sup> The impetus for its introduction was “*a spate of Australian corporate collapses in the 1980s, which resulted in the significant withdrawal of capital (especially foreign capital) from the Australian market*”.<sup>19</sup>
- 2.7 The prohibition on misleading and deceptive conduct is broader and certainly more entrenched in Australian law than the continuous disclosure regime, having originated with s 52 of the *Trade Practices Act 1974* (Cth).
- 2.8 The laws proposed to be reviewed have been in their current form since 2002.<sup>20</sup> A wide range of enforcement measures have been enacted, including the right for affected shareholders to seek compensation for their losses (which right has been part of the regime since 1994).
- 2.9 It is unarguable today that institutional investors and the public expect corporations, listed on public exchanges, to avoid conduct that breaches either standard.<sup>21</sup> Australian investors increasingly avail themselves of the opportunity class actions present to recover compensation for losses caused by such misconduct.

### **Concerns that shareholder class actions give rise to ‘unintended consequences’ is misplaced**

- 2.10 The ALRC proposes the review consider three discrete topics, which reflect the ALRC’s concern with “unintended consequences” of shareholder class actions:
- 2.10.1 the propensity for corporate entities to be the target of funded shareholder class actions in Australia;
- 2.10.2 the value of investments of shareholders of the corporate entity at the time when that entity is the target of the class action; and
- 2.10.3 the availability and cost of directors and officers liability insurance cover within the Australian market.
- 2.11 IMF Bentham makes submissions on each of these concerns, which it submits are misplaced.

<sup>14</sup> Chapter 6CA of the *Corporations Act 2001* (Cth) and the ASX Listing Rules. Section 674(1) gives statutory force to ASX Listing Rule 3.1 which states: “*Once an entity becomes aware of any information concerning it that a reasonable person would expect to have a material effect on the price or value of the entity’s securities, the entity must immediately tell ASX that information.*” Limited ‘carve outs’ to this obligation are provided in Listing Rule 3.1A.

<sup>15</sup> Section 1041H(1), *Corporations Act 2001* (Cth), s 12DA(1), *Australian Securities and Investments Commission Act 2001* (Cth), s 18 of the Australian Consumer Law in Schedule 2, *Competition and Consumer Act 2010* (Cth).

<sup>16</sup> By the *Corporate Law Reform Act 1994* (Cth), *idem*.

<sup>17</sup> A summary of the history of the continuous disclosure regime is helpfully set out in the Full Federal Court’s decision in *Grant-Taylor v Babcock & Brown Limited (in liquidation)* [2016] FCAFC 60 at [92], [101] – [104]. The Court noted at [102] that “*Chapter 6CA (as it now operates) however generally widened the scope of the continuous disclosure provisions, as compared with the prior provisions, by removing the elements required of intentional, reckless or negligent non-disclosure.*”

<sup>18</sup> The civil penalty regime was applied to continuous disclosure in 2002 and in 2004 the CLERP 9 Act introduced civil penalties for involvement in breaches of continuous disclosure and the ability for ASIC to issue infringement notices: Baxt, Black and Hanrahan, *supra n 14*, [7.2].

<sup>19</sup> *Jubilee Mines NL v Riley* [2009] WASCA 62, [45] per Martin CJ.

<sup>20</sup> By the *Financial Services Reform Act 2001* (Cth); Discussion Paper, [1.72].

<sup>21</sup> Typically, a breach of continuous disclosure entails a breach of the misleading conduct provisions.



Propensity for ASX-listed companies to be subject to a shareholder class action

2.12 Class actions do not create causes of action that do not otherwise exist. The propensity for an ASX-listed company to be the target of a funded shareholder class action fundamentally depends on its compliance with the law. The fact that laws are being enforced, through the mechanism of class actions, is not a reason to review the laws, and certainly not a reason to water them down.

2.13 Lax corporate governance processes, poor board oversight, an overconfident CEO, a reluctance to release negative news and inadequate auditing are among the causes of shareholder litigation.<sup>22</sup> Companies with strong internal controls, an independent board that closely monitors management and a culture of compliance have little to fear.

2.14 The incidence of class actions in Australia of all types remains low. As the ALRC notes:

*“Despite concerns that the floodgates of litigation would open as a consequence of Part IVA, the number of class actions has grown steadily, but not exponentially, since the introduction of the legislation.”<sup>23</sup>*

2.15 The ALRC draws a comparison with Canada and the United Kingdom, where some commentators maintain listed companies face a lower statistical risk of being subject to a securities class action than their counterparts in Australia.<sup>24</sup>

2.16 Professor Vince Morabito has comprehensively debunked the myth that Australia is second only to the United States for class action litigation. He notes that jurisdictions such as Israel, Quebec, Ontario and Poland have significantly higher rates of class action litigation per capita than Australia and the fact that:

*“the 98 class actions in question [filed in the Federal Court of Australia] were filed with respect to a total of 73 disputes; and (b) that in a country with a population of over 24 million people, an annual average of 24 class actions filed over the last four years in the country’s national court, cannot rationally be viewed as excessive.”<sup>25</sup>*

2.17 The UK had traditionally rejected statutory rights of action for shareholders in favour of retaining more restrictive common law rules, however, this has now changed<sup>26</sup> and the UK is currently witnessing a rise in collective securities actions.<sup>27</sup> Indeed a 674-page text book entitled *“Class Actions in England and Wales”* has just been published by Sweet & Maxwell.<sup>28</sup>

2.18 Further, shareholder class actions provide important reinforcement for ASIC’s role in regulating the corporate sector.<sup>29</sup> If private class actions are curtailed, ASIC’s budget would need to be

<sup>22</sup> M Humphery-Jenner, S Banerjee and V Nanda, ‘What’s behind the rise in shareholder class actions’, *The Conversation* (9 February 2017).

<sup>23</sup> Discussion Paper, [1.4].

<sup>24</sup> See, for example, XL Catlin and Wotton + Kearney, ‘How did we get here? The history and development of securities class actions in Australia’, (May 2017), 9. The Productivity Commission has also debunked the myth that Australia is heading down the road to becoming as litigious as the US in securities claims: Productivity Commission 2014, *Access to Justice Arrangements*, Inquiry Report No 72, Canberra, 618.

<sup>25</sup> V Morabito, *supra* n 2, 9.

<sup>26</sup> Sections 90 and 90A, Financial Services and Markets Act 2000 (UK).

<sup>27</sup> M Getz and P Barnett, ‘Collective action and securities law in the UK: recent and anticipated developments and international trends’, (May 2017) JIBFL 299 available at <https://www.bsflp.com/images/content/2/5/v2/2528/2017-05-01-Getz-and-Barnett-Collective-Action-and-Securities-Law.pdf>.

<sup>28</sup> D Grave, M McIntosh and G Rowan (General Editors), *Class Actions in England and Wales* (1<sup>st</sup> ed, 2018).

<sup>29</sup> Welsh and Morabito, *supra* n 10, at 47: “An advantage of a system that allows for both public regulation and class actions is that it is likely that a greater number of enforcement actions will be instigated and a greater

increased if the current level of enforcement is to be maintained.<sup>30</sup>

#### Value of shareholder investments in companies subject to class actions

- 2.19 The ALRC proposes the review consider “*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 refers, in a footnote, to a number of academic articles which, among other things, discuss the so-called ‘circularity’ argument.
- 2.20 The circularity argument posits that shareholder class actions “reflect socially inefficient transfer payments”<sup>31</sup>, in that damages are paid by one group of shareholders to another group, less substantial fees paid to lawyers and litigation funders along the way.
- 2.21 There is no academic consensus on the ‘circularity’ thesis.<sup>32</sup> Welsh and Morabito, for instance, observe that the argument:
- “actually constitutes, in our view, a critique of the conferral of substantive rights on aggrieved shareholders in the first place. In fact, whilst class actions can be said to have substantive effect, to the extent that they enable victims of illegal conduct to secure access to our courts (something they would probably not have been able to do absent the class action device), they do not create substantive rights. Thus, an attack on the practical utility of investor and securities class actions is essentially an attack on the wisdom of conferring upon dissatisfied investors the right to seek, from courts, compensation for their losses.”*<sup>33</sup>
- 2.22 So far as IMF Bentham is aware, the ‘circularity’ argument has not been subject to empirical analysis and remains a hypothesis.<sup>34</sup> It ignores the role played by insurance in meeting companies’ liability for securities claims, the fact that the claims are generally by entities who have sold some or all of their shares (indeed claimants may have sold their entire shareholding), the deterrent effect of shareholder class actions on corporate malfeasance, and has no relevance where claims are brought against an insolvent entity.
- 2.23 One issue which does arise is whether shareholder class actions favour recent purchasers of shares in the company concerned, over the interests of existing and long-term shareholders.
- 2.24 Shareholder class actions commonly assert claims by investors who *purchased* shares while the market price was inflated due to inadequate disclosure, with such shareholders forming the class on whose behalf the action is brought.
- 2.25 However, *any* shareholders who purchased, held or sold shares at a market price that did not reflect the price that would have prevailed absent misleading or deceptive conduct by the company or its officers and/or a breach of the continuous disclosure laws may be able to

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*number of wrongdoers will be held to account than would be the case under a regime that relied solely on either public or private enforcement. Public regulators have limited resources and are not able to take action in response to every contravention that would warrant it.”*

<sup>30</sup> As would ASIC’s willingness to seek compensation orders in civil penalty proceedings if affected investors are to continue to receive compensation for their losses: I Ramsay, ‘Enforcement of Continuous Disclosure Laws by the Australian Securities and Investments Commission’ (2015) *C&SLJ* 196, 202 (“ASIC . . . has typically not sought compensation on behalf of investors.”).

<sup>31</sup> J E Fisch, ‘Confronting the Circularity Problem in Private Securities Litigation’, (2009) *Wisconsin Law Review* 333.

<sup>32</sup> Cf P Miller, ‘Shareholder class actions: are they good for shareholders?’, (2012) 86 *Australian Law Journal* 633, 634.

<sup>33</sup> Welsh and Morabito, *supra* n 10, 49 at n 32.

<sup>34</sup> T A Dubbs, ‘A Scotch Verdict on “Circularity” and Other Issues’, (2009) *Wisconsin Law Review* 455, 463.

prosecute claims through a class action if they suffered loss as a result.<sup>35</sup>

In any event, it is still in the interests of shareholders who do not suffer loss in such circumstances and who therefore cannot claim, for the laws relating to continuous disclosure to be enforced. The fact that company money (where there is no, or inadequate, insurance) is used to pay compensation is not a reason to water the laws down. Otherwise that argument would apply to every law which imposes a penalty or compensation obligations on a company.

#### The availability and cost of D&O cover in the Australian market

- 2.26 The availability and cost of D&O insurance is the third example of the “unintended consequences” of shareholder class actions cited by the ALRC.
- 2.27 An immediate difficulty with this aspect of the ALRC’s analysis is the lack of verifiable public data on which the ALRC, or anyone else, can rely. Much of the information on the insurance markets and D&O cover, in particular, is historical, averaged or anecdotal.<sup>36</sup> Furthermore, any adjustments in premiums occurring in the Australian market may simply be reflective of premiums catching up with those prevailing in other international centres.
- 2.28 Further, the market for D&O insurance is affected by wider trends in the insurance markets, including those for professional indemnity and financial institutions<sup>37</sup>, which impact D&O coverage irrespective of class actions.
- 2.29 However, even if the insurance industry provided full and detailed disclosure of its long-term and expected performance in the Australian market, insurers would still have to answer the question of why there has apparently been “*chronic under-pricing of D&O business by insurers since at least 2011*”.<sup>38</sup>
- 2.30 As Professor Legg observes, this error is inexplicable since insurers have been on notice, since at least the Aristocrat shareholder class action settlement in 2009 (when \$100m of a \$144.5m settlement was reportedly paid by insurance<sup>39</sup>), of their insureds’ potential exposure to shareholder claims and the industry’s need to make adequate provision for them.
- 2.31 Whatever caused this circumstance, the market is now correcting with premiums, deductibles, exclusions and attachment points rising or becoming tighter to bring supply and demand into balance.<sup>40</sup> It is not necessary to water down shareholders’ rights in order to save the insurance industry from transitory losses or lower profits.

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<sup>35</sup> Cf *Jubilee Mines NL v Riley* [2009] WASCA 62. Mr Riley sued Jubilee for damages arising from his sale of an allotment of shares in Jubilee, made to him when he joined the company, while the market was unaware that nickel had been found on one of the company’s tenements. When Jubilee subsequently announced this information to the ASX, its share price rose 9%. The Court of Appeal of the Supreme Court of Western Australia upheld Jubilee’s appeal against an award of damages of nearly \$3m in favour of Mr Riley on the grounds that, as Jubilee had no intention at the time of the discovery to exploit the nickel find, it was not aware of information ‘which a reasonable person would expect to have a material effect on the price or value’ of its securities and had therefore not breached its continuous disclosure obligations: [125] per Martin CJ.

<sup>36</sup> XL Catlin and Wotton+Kearney, ‘Show me the money!’ (white paper, September 2017), 9.

<sup>37</sup> Increased costs of defending regulatory commissions, including the Hayne royal commission, are “dwarfing the current [Financial Institutions] insurance premium pool estimated at \$250m”: Marsh, ‘Directors & Officers Liability Insurance Market Update’, (May 2018) 2, leading to increased use of exclusions by insurers in FI and D&O policies: A Uribe, ‘Directors hit in Hayne fallout’, *The Australian Financial Review* (Sydney), 9 July 2018, 1.

<sup>38</sup> Discussion Paper, [1.74].

<sup>39</sup> M Legg, ‘Watering down laws may not stem flood of class actions’, *The Australian Financial Review* (Sydney), 21 June 2018, 47.

<sup>40</sup> Marsh, ‘Directors & Officers Liability Insurance Market Update’, (May 2018) 1, 2.

### Possible Improvements to the Enforcement of Continuous Disclosure Laws

- 2.32 If the legal and economic impact of the continuous disclosure and misleading and deceptive provisions are to be reviewed, then in addition to the points made above, IMF Bentham submits that the opportunity should be taken to *improve* the effectiveness of their enforcement by reducing the costs incurred in prosecuting such claims.
- 2.33 One way this could be achieved is through an amendment to the Corporations Act to enact a statutory presumption that any investor who purchases or sells a security on a public exchange does so in reliance on the price for that security as reflecting all information the relevant entity is legally required to disclose in respect of the security (that is, putting the market-based causation theory beyond doubt).<sup>41</sup> Further, the Act could contain presumptions or definitions setting out how the Court ought to quantify damages in shareholder claims.<sup>42</sup>
- 2.34 Both measures would significantly reduce the cost of bringing a shareholder claim by reducing the need for expensive (often overseas) experts to opine on issues of causation and damages.

### 3. Regulation of 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.

- 3.1 IMF Bentham supports the regulation of third-party litigation funders. IMF Bentham applied for and held an Australian Financial Services Licence (**AFSL**) in the period July 2005 to April 2013, reflecting its belief in the need for effective regulation of the industry.<sup>43</sup>
- 3.2 Third party funding arrangements generally encompass contingent obligations to pay multi-million-dollar sums. Prudential regulation to ensure those promises can be met would be aligned with the sort of regulation applicable in the broader financial services industry and would offer valuable consumer protections to claimants, particularly where the third-party funder is a private company (as opposed to an ASX-listed funder where regular financial information about the funding entity is publicly published). The need to licence funders has become pressing with the increased activity of foreign-based funders in this market, a lack of transparency of the financial capacity of unlisted funders, and the increasing attractiveness of litigation funding to one-off, smaller or opportunistic players.
- 3.3 While IMF Bentham considers that the detail of any licensing regime will need to be the subject of a detailed, consultative process likely to be carried out by ASIC if licensing is approved, IMF Bentham makes some general submissions below on key features it submits should be part of the licence’s design.
- 3.4 First, a common licensing regime should apply to all third-party litigation funders operating, or providing funding to parties, in Australia whether they are domestic or foreign concerns. No allowance should be made for the fact that particular funders are currently licenced in any other jurisdiction.

<sup>41</sup> Cf In Ontario, Canada see *Securities Act*, RSO 1990, c 5, s 138.3 conferring a right of action for damages on secondary market investors without having to prove they actually relied on uncorrected misrepresentations in documents released, or oral statements made, to the market, or on timely disclosures made by the responsible issuer.

<sup>42</sup> *Securities Act*, RSO 1990, c 5, s 138.5 setting out the manner in which damages shall be assessed in favour of persons who acquired or disposed of an issuer’s securities in circumstances triggering liability under the Act.

<sup>43</sup> IMF Bentham gave up its AFSL after the introduction of ASIC Regulatory Guide 248.

- 3.5 Second, IMF Bentham agrees with the ALRC that the licence needs to be tailored to the litigation funding industry and that the AFSL, as it has developed, is not appropriate.
- 3.6 Third, IMF Bentham agrees that ASIC should issue the licences, monitor and enforce compliance with them and prosecute any breaches of licence conditions.
- 3.7 Fourth, IMF Bentham agrees that the licence regime should require a funder (be it third party funder or law firm funding on a contingency fee basis) to have sufficient resources (or access to sufficient resources) to be able to back its litigation funding obligations and deliver its services competently, efficiently, honestly and fairly. This entails having sufficient financial and organisational resources. A funder's personnel should include people with qualifications and relevant experience in the conduct or management of litigation and in financial management. Litigation funders should also, in IMF Bentham's submission, be required to establish and maintain a permanent establishment in Australia.
- 3.8 Fifth, the sufficiency of a funder's financial resources should be determined by reference to a number of tests. The tests should have regard to a funder's risk-adjusted liabilities (i.e. recognise that only a proportion of the funder's investments are likely to ultimately be unsuccessful) and take into account that over a period of time the funder will likely receive income from settlements or damages awards in litigation it has funded.
- 3.9 Sixth, the funder should be subject to an annual audit, which includes an audit to ensure the funder is complying with the terms of its licence. Further, the funder should conduct an impairment test in respect of its funded litigation investments on a half-yearly basis, so as to determine whether any of those investments should be written off or provisioned. The results of the audit and impairment test should be reported to ASIC.

**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.

- 3.10 Please see the submission in response to Proposal 3-1 above. The detail of the licensing regime will be the subject of further submissions to ASIC if licensing goes ahead.

**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?

- 3.11 Please see the submission in response to Proposal 3-1 above.

**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.

3.12 Please see the submission in response to Proposal 3-1 above.

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

3.13 IMF Bentham agrees. IMF Bentham was previously a member of the Financial Ombudsman Scheme. Otherwise, please see the submission in response to Proposal 3-1 above.

#### 4. Conflicts 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.

4.1 IMF Bentham supports this proposal.

**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).

4.2 IMF Bentham supports this proposal.

**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.

4.3 IMF Bentham is neutral on this proposal but acknowledges the value of continuing education and specialist expertise. In general, IMF Bentham supports the right of litigants to choose their legal representatives. In class action litigation funded by IMF Bentham, where experienced lawyers bring the case to IMF Bentham for funding, those lawyers are generally appointed to act for the applicants and group members in the funded class action.

**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.

4.4 IMF Bentham supports this proposal. In IMF Bentham’s submission, requiring a strict separation between the funder and the solicitors in respect of funded litigation is the best

approach for minimising, and if they arise effectively managing, any conflicts of interest that may arise and ensuring that the solicitors provide objective advice to applicants and group members. Given the increasing internationalisation of litigation funding, the separation should extend to any relationships the solicitors and funder may have, whether domestically in Australia or in overseas litigation.

4.5 In *Bolitho v Banksia Securities Limited (No 4)* [2014] VSC 582, the solicitor (Mark Elliott) and senior counsel (Norman O'Bryan SC) retained in the matter were restrained from continuing to act for the representative applicant. Mr Elliott, through his superannuation fund, and the wife of Mr O'Bryan were major shareholders in the company that was providing litigation funding for the proceeding. Mr Elliott was also the secretary and a director of the funder.

4.6 Ferguson J said, at [5]:

*"I have reached the conclusion, for the reasons which follow, that the fair-minded, reasonably informed member of the public would conclude that the proper administration of justice requires that Mr O'Bryan and Mr Elliott should be prevented from acting, in the interests of the protection of the integrity of the judicial process and the due administration of justice, including the appearance of justice."*

4.7 Ferguson J referred to the fact that in this litigation "Mr Elliott wears a number of hats" and "as such, the likelihood of conflict is greater because of the increased number of roles that he has."<sup>44</sup> The Court went on to note:

*"The [fair-minded] Observer would be concerned that there is a sufficient risk that Mr Elliott's (indirect) shareholding and position as a director of the Litigation Funder will give the appearance that his role as a solicitor and officer of the court is compromised."*<sup>45</sup>

4.8 For the same reasons, reciprocal arrangements where lawyer A (or an entity incorporated by lawyer A) agrees to fund lawyer B (even if in different jurisdictions) and *vice versa* should not be permitted.

**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.

4.9 IMF Bentham supports this proposal under Australian law and calls for the disclosure of all forms of funding for any proceedings, including respondents' insurance policies.

4.10 IMF Bentham submits that the Australian Solicitors' Conduct Rules should also be amended to impose a positive duty on solicitors to advise their clients of all options reasonably available for funding their litigation, including no win, no fee retainers, third party litigation funding, insurance (including ATE insurance), legal aid and, if permitted, contingency fees, as is currently required of English solicitors.<sup>46</sup>

<sup>44</sup> [2014] VSC 582, [53].

<sup>45</sup> *Idem*.

<sup>46</sup> See the Code of Conduct for solicitors in England and Wales, 'Indicative Behaviour' 1.16, which requires a solicitor to discuss with their client how the client will pay, including whether public funding or insurance might cover the solicitors' fees. This has been interpreted as including third party litigation funding: Solicitors Regulation Authority, *Handbook* (version 19, 1 October 2017).

**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.

4.11 IMF Bentham supports this proposal.

## 5. Contingency Fees [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.

5.1 IMF Bentham opposes Proposal 5-1.

5.2 Contingency fee charging by lawyers is currently prohibited in all States.<sup>47</sup> The case for abolishing the prohibition has not been made out.

5.3 The reason such fees are prohibited in Australia, is that “*they create a more serious conflict of interest than conditional [i.e. no-win, no-fee] costs agreements.*”<sup>48</sup> Professor Morabito has explained the conflicts which can arise:

*“The most persuasive criticism of contingency fee agreements is the potential for conflict of interest which they create in relation to such matters as settlement of the client’s claim. The contingent nature of the lawyer’s remuneration creates a strong financial incentive for the lawyer to ‘accept a small settlement in order to ensure some fees, rather than risk losing at trial and recovering nothing’. This incentive to settle for sub-optimal amounts would appear to exist in relation to both uplift fees and percentage fees.*

*An obvious response to this argument is to say that a client would not accept settlement terms which are contrary to his/her own best interests. Unfortunately, the fear of losing, ‘the client information disadvantage and the inability to evaluate’ the validity of the settlement package recommended by the lawyer may result in the client’s authorisation of inferior recoveries.*

*The losses incurred as a result of the conflicts of interest which exist between principals and agents are described by economic scholars as ‘agency costs’. Given the unreliability of ‘monitoring’ by the client as a means of reducing agency costs, reliance must be placed on other safeguards such as the legal regulatory system and the importance placed by lawyers on maintaining a good reputation.*

<sup>47</sup> See Discussion Paper, [5.5], note 2.

<sup>48</sup> C Parker and A Evans, *Inside Lawyers’ Ethics* (Cambridge University Press, 2007), 192.



*It is difficult to see, however, how the prospect of disciplinary action or loss of reputation can provide an effective means of eliminating agency costs in the context of settlements given that the lawyers in question are able to point to the 'objective' fact that they have achieved a victory on behalf of their clients. Furthermore, as Macey and Miller have pointed out, the devices to reduce agency costs 'are themselves costly'.*"<sup>49</sup>

5.4 Third party litigation funding reduces the agency problem by ensuring that the lawyer is remunerated regardless of the outcome to the litigation and by introducing a sophisticated and skilled repeat participant (the funder) whose interests are aligned with the claimant's but who does not suffer the same level of information disadvantage as the claimant. The lawyers owe their fiduciary duties to the litigants and can be relied upon to prevent overreaching by the funder. In other words, funders and lawyers act as a check on each other with both subject to the overarching supervision of the Court. Allowing contingency fees removes the advantage of these checks and balances.

5.5 As Shueh Hann Lim has argued:

*"...although the use of a litigation funder increases the number of agents with self-interest in the case that is distinct from the client's, the resulting effect is that the client's interests are more protected. As Coffee has suggested, this structure is inherently one in which "agents are watching agents."...Furthermore, even though litigation funders have an incentive to settle early and lock in the gains from their initial investment in the suit, the lawyers, who in Australia are paid on a non-contingent hourly basis, would have little, if any, incentive to settle early and may even wish to stretch out the litigation. Hence the law firms' self-interest would counterbalance those of the litigation funder."*<sup>50</sup>

5.6 One argument that is raised for contingency fees is that their introduction would better allow lawyers to compete with litigation funders. However, the market for litigation funding in Australia is already competitive, with approximately 25 funders now operating domestically.<sup>51</sup> Contingency fees increase the risk of unmeritorious litigation being brought unless lawyers are liable for any adverse costs if the litigation is lost, and are required to hold capital reserves or insurance to give them the capacity to meet any adverse costs orders in the manner proposed for litigation funders.

5.7 Accordingly, if contingency fees are permitted and the traditional role of the lawyer therefore changes to becoming a funder, they should be subject to the same or similar obligations as third party funders under a licensing regime.

5.8 Permitting contingency fees is unlikely to result in small or medium size claims not currently being funded, being funded. Access to justice is unlikely to be increased. If such cases are presently unattractive to third party litigation funders, it makes no sense that they would become attractive to fund when it is the lawyers providing the funding.

5.9 If contingency fees are permitted, then there should be no restriction on a litigation funder part-funding the action with the contingency fee lawyer, provided only one contingent fee is charged.

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<sup>49</sup> V Morabito, "Federal Class Actions, Contingency Fees, and the Rules Governing Litigation Costs" (1995) 21 *Monash University Law Review* 231, 246 – 247 (citations omitted).

<sup>50</sup> S H Lim, 'Do litigation funders add value to corporate governance in Australia?' (2011) 29 *Companies & Securities Law Journal* 135, 149 (citations omitted).

<sup>51</sup> Discussion Paper, [1.12].

**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.

5.10 IMF Bentham opposes the introduction of contingency fees for the reasons given above.

**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?

5.11 As submitted above, IMF Bentham opposes the introduction of contingency fees. This question perhaps indicates a hesitancy with the notion of allowing contingency fees. If they are a good idea, why not allow them across the board?

## 6. Commission Rates in Litigation Funding Agreements

**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.

6.1 IMF Bentham opposes the proposal that the Federal Court should be given an express statutory power to vary or set the commission rate in otherwise valid and binding third-party litigation funding agreements.

6.2 As Justice Michael Lee has said, extra-judicially:

*“The right of a person of legal capacity to contract with whomever they choose and the right to hold another party to their bargain are bedrock to a modern society governed by the rule of law.*

*Anything which can be seen as a departure from the free exercise of those rights, in the absence of some form of catching bargain or other vitiating conduct, in the broad, and by reference to a highly subjective evaluative standard, raises interesting questions and issues that merit reflection.”<sup>52</sup>*

6.3 In their joint judgment in *Fostif* in 2006 Gummow, Hayne and Crennan JJ rejected fears about the ‘fairness’ of the bargain struck between a funder and intended litigant as justifying a general rule that would bar the prosecution of funded litigation. Their Honours observed:

*“to ask whether the bargain struck between a funder and intended litigant is ‘fair’ assumes there is some ascertainable objective standard against which fairness is to be measured and the courts should exercise some (unidentified) power to relieve persons of full age and capacity from bargains otherwise untainted by infirmity.”<sup>53</sup>*

<sup>52</sup> The Hon Justice M B J Lee, ‘Varying Funding Agreements and Freedom of Contract: Some Observations’ (Paper presented at the IMF Bentham Class Actions Research Initiative with UNSW Law: Resolving Class Actions Effectively and Fairly, Sydney, 1 June 2017), 9-10 (emphasis on original).

<sup>53</sup> *Campbells Cash and Carry Pty Limited v Fostif Pty Limited* (2006) 229 CLR 386, [91] – [92].

- 6.4 IMF Bentham respectfully submits that, consistent with the principle of freedom of contract averted to by his Honour Justice Lee (extra judicially) above and the caution expressed by the Justices of the High Court, such a power is unjustified and unnecessary. The Court should permit market forces to determine the fee chargeable. The Federal Court already has power to set a funder's commission rate when making a common fund order and may reject a settlement for approval if the Court considers that the funder's commission (and other costs) render the proposed settlement neither fair nor reasonable for group members.
- 6.5 An ability to vary or set the commission rate risks hindsight bias. Litigation funders normally agree to fund class actions from the outset, before a respondent's defence is received, any other parties are joined, the expert evidence served, any insurance position is known (or more fully known), and crucially before any settlement offer is made by the respondent. The fee reflects a premium for the uncertainty inherent in the litigation. To alter or set the funder's fee once some or all of the above matters are known (and it seems unlikely the Court would increase the funder's fee) deprives the funder of compensation for the risk it took at the outset.
- 6.6 There is no guarantee that a shareholder class action or any other type of class action will settle (or will settle favourably) and a reasonable funder cannot make capital allocation decisions banking on a settlement occurring.

## 7. Statutory Caps on Contingency Fees and Litigation Funding Commissions

**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%?

- 7.1 IMF Bentham's submission is that these questions, should be answered in the negative, and it repeats its response to Proposal-5.3. Litigation is inherently uncertain. While IMF Bentham seeks to fund class actions in which the likely costs and risks are proportionate to the likely damages award, so that group members are likely to achieve a substantial recovery, it is simply not possible to guarantee any particular return or legislate for any particular outcome. Even the best of cases, as assessed following detailed due diligence by the funder, can ultimately yield a disappointing outcome or even be lost.
- 7.2 In these circumstances, the courts need to retain maximum flexibility in approving settlements, including those that ultimately yield less than 50% of the recoveries to group members. Imposing a statutory default of 50% will inevitably restrict the Court's willingness to consider other outcome scenarios, even if the alternative scenarios are justified in the circumstances of the case. All of the parties' (group members, lawyers and funders) returns need to be dealt with on a case-by-case basis. Equally, the Courts currently have power to decline to approve a settlement where the Court considers it is not fair and reasonable.
- 7.3 Imposing a sliding scale so that the larger the settlement, the lower the fee or rate suffers from the same problems. A case-by-case approach is required. A prescribed fee or fee scale risks providing disincentives that may not be in line with group members interests. It may disincentivise funders from using their best endeavours to obtain the highest possible settlement or from taking on cases which are meritorious, but which nevertheless involve more risk for

which they should rationally be rewarded.

**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?

7.4 IMF Bentham supports this proposal, if contingency fees and statutory caps are introduced.

## 8. Alternative Funding

**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?

8.1 While IMF Bentham supports access to justice for meritorious claims, it doubts the utility of this particular proposal.

8.2 The ALRC is concerned that small or medium-sized meritorious class actions may not be able to be brought because they may fail to attract litigation funding. Presumably, these claims would also fail to attract legal aid. The proposal is that the fund be financed by ‘one percent of fees recovered from contingency agreements or litigation funding agreements’.<sup>54</sup>

8.3 The financing and objectives of the proposed fund raise additional questions. Who sets the levy and by what criteria? Will the levy be increased? Will it be decreased over time? Is it proposed to be levied in perpetuity or will a sunset apply? Will the fund be expected to generate its own income from the litigation it funds, even if on a not-for-profit basis? How will the fund’s success be measured and by whom?

8.4 Further, why is the levy only to be paid by third party litigation funders and, if allowed, contingent fee lawyers? Why not lawyers who earn conditional fees or other users of the legal system like claimants themselves or unsuccessful defendants? If the class action fund is made available in the public interest, it would seem most appropriate that all Australians pay for it, if it is to be implemented.

8.5 These issues will need to be fleshed out before any such proposal could be properly considered.

## 9. 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

<sup>54</sup> Discussion Paper, [5.80].

class action is granted on the basis of a common fund order.

- 9.1 IMF Bentham opposes these proposals.
- 9.2 First, there is no justification in amending the words “representing some or all” in s 33C(1) of the *Federal Court of Australia Act 1976* (Cth). For the reasons given elsewhere, Part IVA is working effectively. Representative parties should not be compelled to represent all affected persons if they wish to only represent a subset and group members should be free to expressly choose which lawyer/funder combination they wish to fund or represent them. Accordingly, consistently with “closed” classes not being prohibited, a common fund order should not be required in every class action.
- 9.3 Second, multiple or overlapping class actions commenced in respect of the same, or similar, underlying disputes are a *minority* of all class actions filed in Australia.<sup>55</sup> While some of these cases (e.g. the AMP litigation) have garnered a high media profile, the ALRC needs to be careful to not over-react to the current media interest in a small number of proceedings when making recommendations in respect of broadly-applied case management procedures in the courts.
- 9.4 Third, a sophisticated and nuanced jurisprudence has emerged which seeks to identify the fairest and most efficient way to deal with overlapping class actions on a case-by-case basis. The courts have successfully reconciled the management of closed and open class proceedings in the one case. Professor Morabito’s report of 11 July 2018 lists 10 different approaches taken by the courts in the management of multiple class actions to date.<sup>56</sup> These approaches, which take account of the diverse circumstances that inevitably arise in complex litigation, are not obviously inferior to the approach now being proposed by the ALRC.
- 9.5 There is a conceptual difficulty in identifying what constitutes a “competing class action”. In the case of shareholder class actions, several open class proceedings may be filed against the same defendant in respect of broadly the same conduct but which plead different causes of action, include additional and different defendants, and plead claims over different time periods.
- 9.6 The potential diversity of ways in which “competing class actions” may or may not overlap, makes it essential that the Court use its case management powers on a case-by-case basis to deal with whatever overlaps exists. For example, it may be appropriate to permit one case to proceed as “open” and the other or others to proceed as closed if there are signed funding agreements in those others, or to have a process whereby group members themselves choose. The Court can make orders to achieve efficiency such as requiring the parties to use one counsel team and imposing limitations on multiple experts.
- 9.7 A requirement that class actions only be initiated on an open basis, closes off this type of practical solution and in IMF Bentham’s submission, is inappropriate and limiting. In the end, a degree of multiplicity, where the defendant faces say two or three cases, will be superior to an alternative of hundreds or potentially thousands of separately commenced proceedings by individual group members.
- 9.8 Fourth, the introduction of common fund orders was designed to ‘fix’ the problem of competing class actions.<sup>57</sup> Instead, it has tended to encourage a ‘race to the court’ and has probably resulted in more “competing” class actions.

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<sup>55</sup> See Discussion Paper at [6.4] citing research published by King & Wood Mallesons that 25% of class action proceedings running in 2015-16 were related actions. Professor Morabito has stated that as at 30 June 2018 “there have been 28 instances or sets of overlapping class actions in Australia”, which is hardly a deluge: V Morabito, *supra* n 2, 13.

<sup>56</sup> V Morabito, *supra* n 2, 15.

<sup>57</sup> See *Money Max Int Pty Ltd (Trustee) v QBE Insurance Group Limited* [2016] FCAFC 148 at [14]: “Further, by encouraging open class proceedings, a common fund approach may reduce the prospect of overlapping or competing class actions and reduce the multiplicity of actions that sometimes occurs with class actions.”

- 9.9 Fifth, IMF Bentham rejects a ‘one size fits all’ approach, proposed by the ALRC, of applying the Federal Court’s *GetSwift* decision<sup>58</sup> in legislation as the dominant or default approach for the management of overlapping class actions. The relevant factors referred to in that decision should not be treated as fixed or finite. Flexibility is required. For example, the benefit of a lower fee charged by a “competing” funder may be outweighed by other factors such as a relative lack of capacity to fund. Flexibility is particularly desirable where there are claims which are not wholly “competing” (see comments above).
- 9.10 The Court itself in *GetSwift* recognised that “*one size does not fit all and how one manages competing class actions is essentially a case management decision rooted in the particular circumstances of the relevant matter.*”<sup>59</sup> The proposed approach of the ALRC, involving Court control over group member choice of lawyers and funder in all cases, is disproportionate to the issues raised by competing class actions.
- 9.11 Although the Court in *Get Swift* decried the relevance of being first in time,<sup>60</sup> the practical effect of not regarding book building as a worthwhile activity and of considering delay in commencement as a relevant factor, reinforces the incentives for lawyers to ‘race to the court’. The lack of attributing any value to having claimants signed up to funding agreements appears to be accepted by the ALRC. IMF Bentham respectfully disagrees for reasons given above. It is important that there be no incentive for class actions to be commenced before the underlying facts and legal issues have been carefully considered, pleadings have been prepared and the interest of potential group members in joining the class action have been canvassed (best evidenced by their having signed up to participate in a given action).
- 9.12 Sixth, IMF Bentham respectfully agrees with the conclusion of the Victorian Law Reform Commission (VLRC) and the views expressed by Professor Vince Morabito in his latest report that decisively point away from the ALRC’s proposals.<sup>61</sup> Professor Morabito has also cogently argued:
- “With respect, what is the point of ‘imposing’ on our federal class action judges a requirement that they choose between competing class actions but, at the same time, allowing them to disregard this directive if such a step is in the interests of justice? Such a compromise will most likely result in no significant change in this area. In fact, we may disagree with the decisions made by trial judges with respect to individual instances of competing class actions but we cannot dispute the fact that those decisions have been made on the basis of assessments on the part of trial judges as to what is in the interests of justice. Thus, little will change other than creating uncertainty for several years.”*<sup>62</sup>
- 9.13 Seventh, there is simply no justification for subjecting the enforceability of otherwise valid litigation funding agreements to Court approval, as is proposed.
- 9.14 Eighth, in IMF Bentham’s submission the Courts should be primarily guided by the market in deciding which of a set of overlapping class actions should proceed by reference to a range of criteria (that is, the Courts should pay due regard to the value of book building exercises and the evidence they produce of accepted funding terms) and the Courts should retain an untrammelled range of options to ensure that the fairest approach is taken, on a case-by-case basis, in all representative proceedings.
- 9.15 IMF Bentham agrees with Professor Morabito’s suggestion that before any concrete proposals are made for legislative intervention in the management of overlapping class actions, the outcome of the appeal to the Full Court in *GetSwift* (and any potential appeal to the High Court) should be known.<sup>63</sup> The ALRC should consider allowing interested parties an opportunity to make further submissions on this point at that time.

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<sup>58</sup> *Perera v GetSwift Limited* [2018] FCA 732.

<sup>59</sup> *Ibid*, [376].

<sup>60</sup> *Ibid*, [170].

<sup>61</sup> Professor Morabito, *supra* n 2, notes at 18 that the VLRC “*does not consider it necessary to give the Court express legislative power to choose one class action when competing proceedings are filed.*”

<sup>62</sup> V Morabito, *supra* n 2, 20.

<sup>63</sup> *Ibid*, 21.

- 9.16 Ninth, no timeframe should be imposed upon litigants to file a “competing claim” (recognising, as stated above, the difficulty in defining what is a competing claim) that commences from the date the first class action is filed in respect of a dispute. In some instances, properly preparing a potential action can take several years. There are numerous examples of more conservative claimants awaiting the outcomes of inquiries, related litigation, or similar before commencing proceedings in circumstances where others have moved to file proceedings based on the available (but incomplete) information. Introducing a timeframe by which claims must be issued will serve as a *de facto* shortening of the limitation period for any subsequent action once a claim has been issued. A competing claim ought to be issued at any stage within the relevant limitation period and allow for the Court to determine whether it ought to be stayed (if an application for same is made by a respondent). There are simply too many variables in play to suggest that a prescribed timeframe for initiating competing actions is in the best interests of group members.

**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.

- 9.17 As the ALRC notes, any amendment to the Class Action Practice Note should follow from the approach to be adopted in dealing with overlapping class actions. For the reasons set out above, IMF Bentham respectfully rejects the ALRC’s Proposal 6-1 and submits that further submissions should be invited on this issue once the outcome of the appeal in *GetSwift* is known.

**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?

- 9.18 In IMF Bentham’s submission, while it is clearly preferable for one court to hear all actions brought against a respondent in respect of the same underlying dispute, issues of jurisdiction are best dealt with on a case-by-case basis by the courts directly concerned, as is currently occurring in the various class actions concerning AMP Limited.<sup>64</sup>
- 9.19 Alternatively, IMF Bentham notes the Victorian Law Reform Commission’s recommendation that a cross-vesting judicial panel be established to make decisions regarding the appropriate forum to hear overlapping class actions.<sup>65</sup> This proposal has merit and should be seriously considered by the ALRC.
- 9.20 Any proposal by which the Federal Court obtains exclusive jurisdiction over Corporations Law matters the subject of a representative proceeding will require the consent of the States. It would seem unlikely that the States would accede to such a request, some of them having implemented class action legislation substantially reflecting Part IVA of the *Federal Court of Australia Act 1976* (Cth).
- 9.21 Even if the States did agree to such a proposal this would still leave other types of class actions capable of being commenced in State courts.
- 9.22 If other proposals of the ALRC, such as limiting class actions to open classes only, are not uniformly adopted by the States, then the differential in rules may give rise to more circumstances where “competing” class actions are filed in both Federal and State courts. This supports a less prescriptive approach to regulation of class actions and favours some matters being left to the market (such as funders’ fees where there is not a common fund) and

<sup>64</sup> See, for example, *Wigmans v AMP Ltd* [2018] NSWSC 1045 (Stevenson J) and *Wileypark Pty Ltd v AMP Limited* [2018] FCA 1052 (Lee J).

<sup>65</sup> Victorian Law Reform Commission, *Access to Justice – Litigation Funding and Group Proceedings* (Report, 2018), recommendation 12.

to case-by-case management.

## 10. 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.

- 10.1. While IMF Bentham supports any workable proposal that would reduce the cost of class action litigation, it is concerned that the benefits of appointing a referee or costs assessor to assess the lawyers’ costs during the prosecution of a class action and prior to an application for settlement approval may not materially assist in the achievement of this goal.
- 10.2. The *GetSwift* judgment is the genesis of this proposal. It was conceived as a means of combatting the moral hazard of remunerating a funder on a multiple of legal costs incurred.<sup>66</sup> The effectiveness of having ongoing assessment of legal costs remains to be seen. It entails additional cost and a greater burden for the lawyers while the litigation is proceeding and its overall impact on costs may not be great. It may possibly have some utility where the funder has no Australian presence (which would not occur under IMF Bentham’s proposals in relation to licensing (see above)) and no, or only a limited, role in supervising the lawyers. But it would create a cost not otherwise imposed by funders who adopt a more hands on model.
- 10.3. One of the limitations with the proposed approach is that it only seeks to control the *applicant’s* costs. The respondent’s costs are of equal importance when the financial impact of a class action is considered as a whole. Further, the respondent’s costs may reflect strategic or opportunistic behaviour designed to drive up the applicant’s costs and delay or obstruct the resolution of the underlying dispute. The respondent’s lawyers should not be rewarded for such work.
- 10.4. IMF Bentham suggests the ALRC consider the introduction of Court-supervised legal budgeting for *both* sides (similar to the rules introduced following the Jackson review in the UK<sup>67</sup>), with budgets for all parties being set at the outset of the litigation, revisions to them requiring Court approval and costs incurred in excess of the approved budget being unrecoverable.

**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?

- 10.5. IMF Bentham supports this proposal. While there are cases in which the applicant’s solicitors are likely to prove the most skilled, efficient and appropriate administrators (the ALRC refers to some of these circumstances at [7.30] in the Discussion Paper), solicitors do not need to administer every settlement scheme, as is typically the case now. There are many, likely cheaper, alternatives.
- 10.6. IMF Bentham therefore supports settlement administrations being subject to a tender process with the Court to decide the outcome. The solicitors or, if the matter is funded, the funder would also be free to tender with the Court to make the final selection.

<sup>66</sup> *Perera v GetSwift Limited* [2018] FCA 732, [292].

<sup>67</sup> See Civil Procedure Rules 3.12 to 3.18 and Practice Direction 3E. Note the cost budgeting rules do not apply to monetary claims of £10m or more. No such restriction should apply if such an approach is adopted in Australia.



**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?

- 10.7. IMF Bentham opposes this proposal as it may discourage parties from reaching settlements, increasing the cost and time taken to resolve class action litigation, or may result in less advantageous settlements for group members.
- 10.8. In IMF Bentham’s experience respondents and/or their insurers routinely require confidentiality as a condition of settlement. In some cases, the respondent may allow some information to be publicly disclosed, such as the settlement sum. Applicants, their legal representatives and funders take any such condition seriously as its breach may nullify the settlement.
- 10.9. Ultimately the degree of confidentiality attaching to any settlement should be a matter for negotiation by the parties and their representatives, subject to the Courts power and relevant discretion. Provided group members and the Court are informed of the full settlement terms, why should the public know? The exception may be public interest litigation and the Courts can deal with such exceptions on a case-by-case basis.

## 11. 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.

- 11.1. IMF Bentham makes submissions against this proposal on efficacy grounds, although it supports the general principle of providing compensation to persons who have been wronged. IMF Bentham recognises that it is primarily the attitude of regulators to such a proposal that will determine whether it is implemented or not.
- 11.2. Australia’s regulatory agencies already have power to seek enforceable undertakings on terms which include the payment of compensation to persons affected by alleged contraventions of the law.<sup>68</sup> Co-operation with ASIC and the ACCC by wrongdoers is taken into account when the regulators are carrying out their enforcement roles.<sup>69</sup> All of the elements of the proposed collective redress scheme are in place now.
- 11.3. The proposed collective redress scheme is intended to avoid the high costs associated with litigation. However, litigation ensures that the wrongdoing is subject to public process, claimants are alerted to their rights and receive legal advice in respect of them, discovery is given, liability and causally-connected loss are fully investigated and assessed, procedural fairness accorded the parties under judicial supervision and, if necessary, the Court will provide a binding determination according to law.<sup>70</sup>

<sup>68</sup> See ss 93A and 93AA of the *Australian Securities and Investments Commission Act 2001* (Cth) in respect of ASIC and s 87B of the *Competition and Consumer Act 2010* (Cth) in respect of the ACCC.

<sup>69</sup> Australian Securities and Investments Commission, *ASIC’s approach to enforcement* (Information Sheet 151, September 2013), 10; Australian Competition and Consumer Commission, *ACCC Cooperation Policy for Enforcement Matters* (Paper, July 2002).

<sup>70</sup> See M Legg, ‘A Comparison of Regulatory Enforcement, Class Actions and Alternative Dispute Resolution in Compensating Financial Consumers’ (2016) 38 *Sydney Law Review* 311, 334, 337.

- 11.4. In any event, the proposed scheme will permit individuals and businesses who may have been affected by the misconduct to opt out, potentially undermining the aimed-for efficiencies of the scheme.

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

- 11.5. Not applicable given IMF Bentham’s response to this proposal.