



THE LAW SOCIETY
OF NEW SOUTH WALES

Our ref: LLP: RHce: 1923756

29 May 2020

Ms Margery Nicoll
Acting Chief Executive Officer
Law Council of Australia
DX 5719 Canberra

By email: john.farrell@lawcouncil.asn.au

Dear Ms Nicoll,

Inquiry into litigation funding and the regulation of the class action industry

The Law Society of NSW thanks you for the opportunity to provide input for a Law Council submission to the Parliamentary Joint Committee on Corporations and Financial Services inquiry into litigation funding and the regulation of the class action industry. The Law Society's Litigation Law and Practice Committee has contributed to this submission.

The Law Society previously provided a submission to the Australian Law Reform Commission ('ALRC') *Inquiry into Class Action Proceedings and Third-Party Litigation Funders*. We **enclose** the letter to the ALRC dated 17 August 2018. [REDACTED]

[REDACTED] We have restated and built upon several of our comments [REDACTED] to the extent that they relate to the terms of reference of the present inquiry. Our response to relevant terms of reference are discussed below, numbered as per the Inquiry's terms of reference.

2. The impact of litigation funding on the damages and other compensation received by class members in class actions funded by litigation funders

Litigation funding has a clear impact on the amount of damages or compensation available to class members in class actions funded by litigation funders. Litigation funders expect that any investment will bring a return beyond the mere recovery of legal fees and disbursements paid. Funding agreements traditionally rely on a percentage of the amount recovered. The percentage may vary depending on when a matter resolves, whereby a lower percentage will be received if the matter resolves at an early stage through to a higher percentage if the matter resolves later.

Funding equalisation orders and common fund orders also impact on the amount of damages awarded to group members. A common fund order will likely have the most dramatic impact on the amount recoverable. For example, a sum of 25% on any gross damages award may,¹ depending on the gross settlement sum, greatly exceed the legal

¹ Based on the percentage recently awarded in *Uren v RMBL Investments Ltd (No 2)* [2020] FCA 647.

costs and any commission payable from funded group members. Assuming a gross settlement sum of \$100 million on a securities class action claim, this would mean an award of \$25 million for a litigation funder. In addition to having legal costs and disbursements recovered and reimbursed, the litigation funder claims a significant additional amount out of the settlement amount that would otherwise be received by class members.

A funding equalisation order will also impact the amount recoverable, however, it will likely do so to a lesser extent than a common fund order. This is because a funding equalisation order simply spreads the amount of the commission that the litigation funder would be entitled to across all participating group members. In our view, this is a more fair and equitable resolution for all group members whilst still allowing the litigation funder to retain its contractually agreed benefit.

3. The potential impact of proposals to allow contingency fees and whether this could lead to less financially viable outcomes for plaintiffs

The current prohibition on contingency fees exists to ensure that plaintiffs do not see the returns from their claim consumed by excessive legal fees. A clear example of this risk is evident in the case of *Fitzgerald & Anor v CBL Insurance Ltd (No. 2)* ("Huon"),² considered by the Victorian Law Reform Commission. In Huon, the former trustees of Huon Corporation, suing CBL Insurance Ltd, would have been unable to bring the action without funding, but the high rates of commission charged and significant legal fees meant that the trustees "ultimately received nothing from the amount awarded".³ The Law Society considers that contingency fees may not, in practice, necessarily provide access to justice, as smaller claims are the most likely to be consumed by contingency fees.

Generally speaking, in most cases a contingency fee arrangement will be higher than the legal costs would have been to litigate a matter because it is based, not on the amount of work employed to litigate the matter, but on a percentage of the eventual outcome.

Whether the introduction of contingency fee arrangements would result in *reduced* costs to litigants in class action matters can only be determined on a case by case basis. We note that in a number of cases the courts have questioned the totality of legal fees charged and payable as part of a settlement. In such cases, the courts have used experts and referees at the settlement approval stage to attempt to gauge whether the fees are fair and reasonable.

Further, in the case of representative proceedings, such as in proceedings involving alleged continuous disclosure breaches where losses by individual shareholders may be quite small, and where the class members have no realistic economic capacity to bring proceedings, any settlement sum which is ultimately payable to them may be gratefully received. As such, there is no real transparency or ability for those class members to analyse whether the result and the amount taken in fees, is a good one from their perspective. This highlights the necessity for close scrutiny by the court of:

- i. all the arrangements by lawyers acting for plaintiffs in representative proceedings; and
- ii. all the funding arrangements, to ensure that justice is both done and seen to be done.

² [2015] VSC 176.

³ Victorian Law Reform Commission, *Access to Justice – Litigation Funding and Group Proceedings* (Report, March 2018) [2.40].

4. The financial and organisational relationship between litigation funders and lawyers acting for plaintiffs in funded litigation and whether these relationships have the capacity to impact on plaintiff lawyers' duties to their clients

A relationship between a litigation funder and a lawyer that is purely contractual is largely accepted and, where it exists, a proper exercise of a lawyer's fiduciary obligations ought to be sufficient to prevent conflicts of interest. However, the litigation funder and law firm may also have a relationship which is not merely contractual; for example, they exist within a single entity and/or under the direction of a single Director. Where this relationship exists, there is a greater risk of a conflict of interest or abuse of process occurring. We suggest that consideration be given to the requirement for a strict separation which prevents a lawyer from acting for an applicant in a class action in circumstances where the lawyer, or a close associate of the lawyer, is also a Director of a litigation funding organisation. Appropriate exceptions to such rules should exist, such as when the litigation funder is a publicly listed company.

5. The Australian financial services regulatory regime and its application to litigation funding

In 2009, the Federal Court of Australia found that the litigation funding arrangements under consideration constituted a "managed investment scheme".⁴ Further, in 2011 the NSW Court of Appeal found that a litigation funding arrangement was a "financial product" under s 763A of the *Corporations Act 2001* (Cth).⁵ On appeal, the High Court of Australia held that the funder in that case was a "credit facility".⁶

In response to these findings, the Commonwealth Government in 2012 exempted "funders" from the definition of "managed investment scheme", but only on the condition that litigation funders had necessary processes in place to manage conflicts of interest. Exempt litigation funders are subject to the Australian Securities Investments Commission (ASIC) Regulatory Guide 248.

In its Final Report "Integrity, Fairness and Efficiency - An Inquiry into Class Action Proceedings and Third-Party Litigation Funders" ("Final Report"), the ALRC recommended that the existing ASIC Regulatory Guide 248 be amended to require third-party litigation funders to report to ASIC to show compliance with the requirements to meet certain obligations to avoid or mitigate conflicts of interest.⁷

However, the ALRC further noted that the current definition for exemption does not capture the increasingly broad range of litigation funding models that are appearing in the Australian market, meaning that whether an exempt third-party litigation funder is required to comply with Regulatory Guide 248 may be unclear. The ALRC noted that it received competing submissions as to whether the ASIC Regulatory Guide 248 is sufficient to regulate litigation funders,⁸ and has previously observed that there is little oversight or action from ASIC in this context.⁹

⁴ Australian Law Reform Commission, *Integrity, Fairness and Efficiency-An Inquiry into Class Action Proceedings and Third-Party Litigation Funders* (Final Report, December 2018) [6.7] ("Final Report") citing *Brookfield Multiplex Limited v International Litigation Funding Partners Pte Ltd* (2009) 180 FCR 11.

⁵ *International Litigation Partners Pte Ltd v Chameleon Mining NL* (2011) 276 ALR 138.

⁶ *International Litigation Partners Pte Ltd v Chameleon Mining NL (Receivers and Managers appointed)* (2012) 246 CLR 455; Australian Law Reform Commission (n 2) [4.15].

⁷ Final Report [6.108].

⁸ Final Report [6.106].

⁹ Final Report [6.109].

The Law Society is concerned with the adequacy of an ASIC Regulatory Guide to effectively manage the potential risks of conflicts of interests and also regulate litigation funders in this context without other regulatory tools to enforce compliance. As noted by the Victorian Law Reform Commission, whilst the courts play a role in supervising litigation funders in legal proceedings, they can only do so on a case by case basis,¹⁰ and the role therefore is limited in several respects.

We note that the Federal Government has recently announced that litigation funders will be required to hold an Australian Financial Services Licence and will no longer be exempt from complying with the statutory regime governing managed investment schemes. In principle, we support litigation funders being subject to greater regulatory oversight, particularly noting the decision in the Federal Court of Australia that litigation funders meet the criteria of a managed investment scheme. We look forward to reviewing the details of the reforms once released.

6. The regulation and oversight of the litigation funding industry and litigation funding agreements

The Law Society recognises the importance of litigation funders in class action proceedings, including the fact that a number of actions would not be able to be brought without their funding.¹¹ However, observed from a purely commercial perspective, a litigation funder is essentially using a chose in action, held by the members in the class, to seek to make a profit. As such, they are providing a type of financial product. Considering the significant financial incentives for litigation funders and the growth in class action proceedings, the Law Society is of the view that regulation is necessary to manage the concomitant risks to group members. We submit that litigation funders should thus be under particular regulatory obligations that are enforceable against them.

The Law Society notes that a number of arguments against introducing further regulation of litigation funders are based on concerns with “over-regulation” and the imposition of unnecessary restrictions in the market and competition.¹² We accept that regulation may have an impact on litigation funding competition and create a barrier to entry into the market for litigation funders. If there are less litigation funders, it may follow that smaller value class actions may not receive funding, and with less competition, commission percentages in litigation funding agreements may rise.

This tension was acknowledged by the ALRC in its Final Report:

Tension exists between the perceived need for a licensing regime to ensure that litigation funders have the ability to meet their financial obligations (to indemnify the plaintiff in the event of an adverse costs order and to meet their commitment to fund the plaintiff's lawyer) and manage the conflicts that are inherent in any funding agreement, and the risk that a licensing regime may unnecessarily stifle competition amongst funders and thus artificially inflate the cost of funding.¹³

These risks are, in the view of the Law Society, outweighed by the risks and consequences of unmanaged conflicts of interest. The Law Society believes that a licensing regime can be

¹⁰ Victorian Law Reform Commission (n 4) [2.21].

¹¹ *Newstart 123 Pty Ltd v Billabong International* (2016) 343 ALR 662 [51].

¹² See for example, submissions to the Victoria Law Reform Commission (n 8) 19 [2.30] including Julie-Anne Tarr, Submission No 3 to Victorian law Reform Commission, *Access to Justice - Litigation Funding and Group Proceedings* (28 August 2017) and Slater and Gordon, Submission No 28 to Victorian law Reform Commission, *Access to Justice - Litigation Funding and Group Proceedings* (October 2017).

¹³ Final Report [1.41].

a powerful regulatory tool due to the possibility of a licence being revoked, its terms being modified or of an investigation being commenced in the event that a licence holder fails to meet or adequately satisfy ongoing conditions of a licence. Accordingly, in a licensing regime, both the conditions of the licence and the form of the regime require careful consideration and should only be imposed to the extent necessary. It is important to ensure that any regulatory scheme protects group members and the integrity of the judicial system but does not overly burden potential litigation funders or prevent potential group members bringing an action.

We also acknowledge the importance of ensuring that any regulatory scheme is consistent across all jurisdictions and subject to national oversight. Class actions can and do span various jurisdictions, and if different regulatory frameworks are in place, there will be operational challenges for the profession and potentially duplicated costs and expenses.

Lastly, we note that whilst the Federal Court of Australia plays an essential role in the regulation of litigation funders, the role and powers of the courts are currently not sufficient to regulate their conduct.¹⁴ The Law Society suggests that the Federal Court and Supreme Court of NSW (and potentially Supreme Courts in other jurisdictions, where supported locally) be given the statutory authority to vary or reject the terms of agreements made between class members and litigation funders, to the extent that it is necessary to ensure a reasonable outcome for group members. We also suggest that the terms of any external funding agreement should be viewed and subjected to approval by the Courts during the early stages of proceedings, to ensure the best interests of class members are preserved. This position is aligned with recommendations made by the ALRC, that leave of the Federal Court be required for lawyers to enforce contingency fee agreements in class action proceedings, and that the Court have the power to vary or reject the fee charged if necessary.¹⁵

7. The application of common fund orders and similar arrangements in class actions

In addition to comments made above in response to the second term of reference, the Law Society has concerns regarding the Justice Legislation Miscellaneous Amendments Bill 2019 (“the Bill”) in Victoria. The Bill, if passed, will allow the Supreme Court of Victoria to make group costs orders in class actions. The group costs orders will introduce the possibility for solicitor contingency fees by enabling the Court to make an order that the legal costs payable to the law practice representing group members be calculated as a percentage of the amount of any award or settlement.

Following the recent High Court decision in *BMW Australia Ltd v Brewster; Westpac Banking Corporation v Lenthall*, where the High Court determined that common fund orders were not permitted by s 33ZF of the *Federal Court of Australia Act 1976* (Cth) or s 183 of the *Civil Procedure Act 2005* (NSW),¹⁶ and pending resolution of whether common fund orders are available under s 33V of the *Federal Court of Australia Act 1976* (Cth),¹⁷ we are concerned that the Bill may create a ‘forum shopping’ effect on class action litigations across Australia by encouraging the commencement of class actions in Victoria. Moreover, the Bill has the potential to undermine many years of work in moving toward a uniform national framework regulating the legal profession.

¹⁴ See Federal Court of Australia, *Class Actions Practice Note (GPN-CA)*, 20 December 2019, 5.

¹⁵ Final Report [7.83].

¹⁶ [2019] 94 ALJR 51 [3].

¹⁷ See *Fisher (trustee for the Tramik Super Fund Trust) v Vocus Group Limited (No 2)* [2020] FCA 579.

8. Factors driving the increasing prevalence of class action proceedings in Australia

The Law Society recognises the clear growth of particular types of class action proceedings in Australia. For example, over the past 25 years shareholder class actions has increased from 12 per cent to 52 per cent of all class action claims.¹⁸

Though there is no determinative evidence on what precisely underpins the increasing prevalence of class action proceedings in Australia, one can assume that the significant economic potential is a driver of investment in class actions.¹⁹ At least \$3.5 billion has been paid by respondents in class action settlements approved by the courts.²⁰ For litigation funders, not only are costs recoverable, but the advent of common fund orders has meant that the return on investment for litigation funders can be significant. Further, the existence of 'After the Event' insurance policies, which can protect litigation funders and plaintiffs from the risks of adverse costs orders, may also provide an added level of comfort to those who purchase a policy before funding or commencing an action.

We also note that, overall, class actions are a relatively 'new' form of litigation. As the market for class actions matures, some degree of growth is to be expected as knowledge and awareness is developed, successful actions encourage others to proceed, and there exists an option for funding of matters that might otherwise not have been feasible for group members to pursue.

In our view, the issue of most concern is not the growth in class actions in and of itself, but rather, whether unmeritorious or speculative class actions are being pursued as result of driving factors. If so, an appropriate certification or procedure could be considered to require approval from the court before an action can proceed.

11. The consequences of allowing Australian lawyers to enter into contingency fee agreements or a court to make a costs order based on the percentage of any judgment or settlement.

Creation of conflicts of interest

The Law Society considers that the introduction of contingency fees would raise conflict of interest risks that ought not be accepted, and which are not possible to satisfactorily overcome. Solicitors are bound by their fundamental ethical obligations to avoid any compromise to their professional independence and to avoid conflicts of interest, as set out in the *Legal Profession Uniform Law Australian Solicitors' Conduct Rules 2015*. While courts might be able to play a role in reviewing such arrangements, we consider that this could only ever be a limited safeguard. [REDACTED]

It is also noted that solicitors are expected to run the risk of adverse costs orders and security for costs if a scheme such as that proposed in Victoria is introduced. There will be matters where this will create a conflict of interest between the solicitor and the client in the sense that the client may have a claim with merit of which the solicitor forms a view that the

¹⁸ Jason Betts, 'Why class action regime should be regulated' *The Australian* (11 May 2018).

¹⁹ Jason Betts, David Taylor and Christine Tran, 'Litigation Funding for Class Actions' in Damian Grave and Helen Mould (eds) *25 Years of Class Actions in Australia* (The Ross Parsons Centre of Commercial Corporate and Taxation Law, Publication 19), 205, 227.

²⁰ The Honourable Justice Bernard Murphy and Vince Morabito, 'The First 25 years: Has the Class Action Regime hit the Mark on Access to Justice?' in Damian Grave and Helen Mould (eds) *25 Years of Class Actions in Australia* (The Ross Parsons Centre of Commercial Corporate and Taxation Law, Publication 19), 13, 22.

risks of adverse costs or security for costs outweigh the solicitor's interest in taking on the matter.

Disproportionality of fees

The Law Society is concerned that the proportion of settlement payments absorbed in contingency fees may be very significant and that a contingency fee regime may not always be best promoting the interests of litigants, and in particular, group members.²¹

The ALRC noted that in matters that would otherwise have attracted third-party litigation funding, there is a genuine concern that “percentage-based fees will provide a method by which law firms can increase their billings disproportionately.”²² In recommending that leave of the Federal Court be required for lawyers to enforce contingency fee agreements in class action proceedings,²³ the ALRC considered that “safeguards built into the recommendation are necessary to prevent a ‘windfall’ for lawyers acting in class actions”.²⁴

Promote competition between practitioners and third-party litigation funders

A view of some members of the Law Society is that the introduction of contingency fee arrangements may lead to the proliferation of class actions and provide an opportunity to bring more competitive tension into the selection of both lawyers (and their rates) and funders (and their commissions and other contractual terms) and the arrangements by which the lawyers and funders operate together as a common enterprise.

While we accept there would be some increase in competition, it is unclear whether this increase will relate to competition between practitioners and third-party litigation funders. One major consideration is the inherent differences between the roles/interests of solicitors and that of third-party litigation funders. Only a small pool of law firms have the financial resources to compete with litigation funders. From this perspective it is unclear whether allowing contingency fees will in fact encourage competition from smaller firms.

12. The potential impact of Australia’s current class action industry on vulnerable Australian business already suffering the impacts of the COVID-19 pandemic

Despite the challenges presented by the COVID-19 pandemic to businesses around Australia, it is the Law Society’s view that this should not be a basis to prevent well-founded class actions from proceeding.

We note the recent announcement from the Federal Government that it has modified the continuous disclosure provisions of the *Corporations Act 2001* in an effort to provide temporary relief to companies and officers for a six month period to protect against ‘opportunistic’ class action lawsuits during the COVID-19 pandemic. Companies and directors will now only be liable for sharing wrong information because of “knowledge, recklessness or negligence”.²⁵

²¹ However, some of the Law Society’s members consider contingency fees may be appropriate in class actions where there is considerable judicial oversight but do not support permitting solicitors to enter into contingency fee arrangements in other matters.

²² Final Report [7.109].

²³ Final Report [7.104].

²⁴ Final Report [7.116].

²⁵ Josh Frydenberg, ‘Litigation Funders to be Regulated under the Corporations Act’ (Media Release, Treasury, 22 May 2020); *Corporations (Coronavirus Economic Response) Determination (No. 2) 2020* (Cth) sch 1 ss 5-9.

On one view, market disclosure rules impose substantial burdens on directors, providing an easy platform for an allegation that after a material price drop “material information was not immediately disclosed at an earlier time”.²⁶ There are also additional challenges with forecasting, wherein the current continuous disclosure laws do not account for the difficulty for a company which takes three months to prepare a market guidance, but then is required to “immediately” update the market on a change in conditions.

Given the temporary nature of the recent amendments, and the extraordinary nature of the current business environment, it may be difficult to gauge their effectiveness.

Many businesses have insurance that provide at least some form of coverage for claims that arise. However, against this is the observation that a likely consequence of the number of large-scale shareholder class actions is some forms of insurance covering class actions may be discontinued as a result of the significant costs involved in defending class actions. There have been media reports suggesting directors’ and officers’ insurance providers are being forced to either significantly raise premiums or cease to offer this form of cover.²⁷

14. Any matters related to these terms of reference

Closely linked to any consideration of litigation funding is the issue of whether the courts should be used as the vehicle upon which an investment scheme business model relies. The courts are a publicly funded resource with finite and limited resources. At its core, litigation funding is an investment with the primary aim of making a profit. Allowing the courts to be used in this way does provide access to justice to group members who otherwise may not be able to bring their own claim. However, an essential component of the business model is funded by taxpayers whom arguably do not benefit from the arrangement.

We also note that litigation funding exists across numerous areas of litigation. Our members note that several of the issues raised in this submission are not only limited to class action matters.

Thank you for considering the issues we have raised in this submission. If you would like to discuss in more detail, please contact Claudia Elvy, Policy Lawyer, on 02 9926 0275 or at claudia.elvy@lawsociety.com.au.

Yours sincerely,



Richard Harvey
President

²⁶ Chris Merrit, ‘Class-action shakedown’, *The Australian* (9 June 2018).

²⁷ Damon Kitney, ‘Directors warn of liability insurance crisis’ *The Australian* (26 December 2019).



THE LAW SOCIETY
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Our ref: LLP: DHmj1577640

17 August 2018

The Hon Justice SC Derrington
President
Australian Law Reform Commission
GPO Box 3708
Sydney NSW 2001

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

Dear Justice Derrington,

Australian Law Reform Commission Inquiry into Class Action Proceedings and Third-Party Litigation Funders

Thank you for the opportunity to make a submission to the Australian Law Reform Commission (ALRC) *Inquiry into Class Action Proceedings and Third-Party Litigation Funders*. The Law Society's Litigation Law and Practice, Injury Compensation, Costs, Ethics, Business Law and In-house Counsel Committees contributed to this submission.

We note that, since the release of the ALRC's Discussion Paper, the Victorian Attorney-General tabled the Victorian Law Reform Commission (VLRC) Report, *Access to Justice – Litigation Funding and Group Proceedings*.

It is evident that it would be preferable, if possible, that reforms in Australia's class action systems were to be achieved with some uniformity. While this Submission addresses the Discussion Paper, some references are made to the VLRC Report.

The reforms proposed in the Discussion Paper raise complex issues, and a number of proposals were not universally supported by the members of the Law Society's Committees. As such, in a number of sections below, our comments reflect the issues the ALRC should consider in making its final recommendations, rather than expressing a definitive position on the relevant proposal.

We have grouped our comments according to the Chapters in the Discussion Paper.

Chapter 1: Introduction to the inquiry

Proposal 1-1

The Table at [2.14] of the ALRC Discussion Paper highlights that class action claims by shareholders in the Federal Court have in all cases been funded by third parties. That table also indicates that in the five-year period 2013 – 2018, shareholder and investor claims represented 54 of the 71 funded class actions.

At [1.72] of its Discussion Paper, the ALRC observes that, since the introduction of continuous disclosure and misleading and deceptive conduct provisions in the *Corporations Act 2001* in 2002, no action based on those provisions has proceeded to judgment.

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On one view, market disclosure rules impose substantial burdens on directors, providing an easy platform for an allegation that after a material price drop “material information was not immediately disclosed at an earlier time”.¹ There are also additional challenges with forecasting, wherein the current continuous disclosure laws do not account for the difficulty for a company which takes three months to prepare a market guidance, but then is required to “immediately” update the market on a change in conditions.

Given the significance for corporations, shareholders and the economy in general of actions based on these statutory obligations and that they have been in place for 16 years, a review of their substantive content and effect may be warranted.

It is interesting to observe that:

*In 1991, when the Lavarch Committee and the Corporations Securities Advisory Committee (CASAC) recommended the introduction of continuous disclosure provisions in the Corporations Law, neither recommended giving shareholders a right to sue the company for contraventions of them.*²

Further, a likely consequence of the number of large scale shareholder class actions is that there may be a disappearance of some forms of insurance covering class actions. Indeed, given the significant costs involved in defending class actions, it appears Side C securities insurance coverage may soon cease to exist because the “average shareholder class action settlement is between \$50m and \$60m. Almost all of them settle” and “[i]nsurers are thought to contribute substantial amounts to these settlements, not to mention legal defence costs”.³

This view is supported by the reality that insurers ceasing to offer directors’ and officers’ (D&O) insurance is not a mere hypothetical but a reality, with at least one significant insurer already leaving the D&O insurance market in Australia due to unfavourable market conditions.⁴

An alternative view is that, given the potential impact of the range of reforms suggested in the Discussion Paper, it may be inappropriate to undertake a review cast in the form proposed by the ARLC, as the questions seem to assume that certain conclusions are likely to be correct and that change is required. The proposal also only addresses the issue in the context of shareholder class actions.

There are a number of arguments that do not support the need to conduct such a review, including:

- The benefits of the current regime are well known and supported by both institutional and retail investors, as well as the key regulators.
- It is the untimely disclosure or the misleading disclosure to the market by publicly listed companies which warrants a securities class action. These class actions then provide a market-based resolution to the enforcement of disclosure of accurate information.
- This proposal, with respect, goes beyond the scope of the referral to the ALRC, and the Discussion Paper does not make a compelling case for such a review at the present time.

¹ C Merrit, “Class-action shakedown”, *The Australian* (9 June 2018)

² P Miller, “Shareholder class actions: Are they good for shareholders?” (2012) 86 *Australian Law Journal* 633, 647.

³ J Betts, “Why class actions regime should be regulated”, *The Australian* (11 May 2018).

⁴ C Merritt, “Class-action shakedown”, *The Australian* (9 June 2018).

- If there is a problem with the cost of director and officer insurance, then the insurance market should “price for the fact class actions are here to stay and will continue to be a feature of the Australian litigation landscape”.⁵
- Justice Lee’s decision in *Perera v GetSwift Limited* [2018] FCA 732 (*GetSwift*) does not suggest a need to revisit the continuous disclosure obligations. To the contrary, as Justice Lee explained at [14]:

I hasten to add that by identifying a commonplace pattern, I do not suggest that the development of the usual form of securities class actions should be looked upon askance. To the contrary, an informed observer would likely recognise that a consequence of these developments has been a heightened awareness among corporations, through their officers, of their obligations to act in such a way as to avoid continuous disclosure breaches and contravention of the norms prohibiting misleading and deceptive conduct. This is not the place to debate the social utility of securities class actions; this would involve a range of considerations which raise complex and collateral assessments (such as, for example, its impact on the price of D&O and ‘Side C’ liability cover), but despite what some would describe as their ‘commercialisation’ and concerns which may arise concerning a premature announcement of a proposed class action that never proceeds, it can be argued cogently that they have served, and continue to serve, a role in not only providing for significant amounts to be paid to investors for claimed losses occasioned by allegations of corporate malefaction (that would, absent securities class actions, never have been paid), but they also have occasioned a private regulatory discipline on the conduct of listed companies and their dealings with the market of investors in their securities.

The Law Society has some concerns about the narrow proposed terms of reference for the review. Rather than being a more general review of the impact of the continuous disclosure provisions themselves, the three issues to be considered in the review are directed solely to their impact in the context of class actions.

Chapter 3: Regulating litigation funders

The ALRC made the following arguments to support its case that there should be further regulation of litigation funders:

- There are no current requirements for litigation funders to hold a licence to operate in Australia. Since July 2013, they have been specifically exempted from the requirement to hold an Australian Financial Services Licence (AFSL). They are required to have appropriate processes for managing conflicts of interest. This obligation is sourced in *Corporations Regulations 2001* (Cth) (*Corporations Regulations*) Reg 7.6.01AB introduced by *Corporations Amendment Regulations 2012* (Cth) Item 6.⁶
- There is a need to provide protection to consumers and other litigants through a licensing regime for litigation funders.⁷

⁵ As acknowledged by Gen Re – see Insurance News, “Class actions: no reprieve for D&O insurers”, Insurance News (online), 18 June 2018, <<http://www.insurancenews.com.au/analysis/class-actions-no-reprieve-for-do-insurers>>.

⁶ Australian Law Reform Commission, *Inquiry into Class Action Proceedings and Third-Party Litigation Funders*, (DP 85), 2018, [3.1].

⁷ *Ibid.* [3.4].

- Whilst it would potentially be possible to require litigation funders to hold an AFSL and adapt the compliance obligations to fit the business of a litigation funder, the ALRC does not recommend that option.⁸
- There is limited evidence of failure of a litigation funder in Australia but the financial viability of litigation funders is vital.⁹
- It is not necessary to regulate litigation funders in the manner that legal practitioners are regulated.¹⁰
- A key requirement of a licensing regime is that litigation funders should be required to have sufficient financial resources in order to conduct their business.¹¹
- The mechanism for providing security for costs, while important, does not negate the need for a capital adequacy requirement.¹²
- Prudential regulation of litigation funders would appear to be inappropriate.¹³
- The requirements for AFSL licensees are a useful starting point for considering the types of financial requirements that may be appropriate as part of a litigation funding licence.¹⁴
- There should be no need for a foreign litigation funder to meet the specific Australian requirements provided they meet comparable requirements in their own jurisdiction.¹⁵
- A licence to litigation funders should provide consumers with protection through an appropriate dispute resolution procedure.¹⁶

The Law Society recognises the importance of litigation funders in class action proceedings, including the fact that a number actions would not be able to brought without their funding.¹⁷ In *P Dawson Nominees Pty Ltd v Multiplex Ltd*, Justice Finkelstein observed the benefits of funding class action:

*The advantage of the retainer and the funding agreements to each group member is obvious. If it were not for those agreements and the class action procedure, the action would probably not have gotten off the ground. Individually, most group members would not have the financial strength to bring their opponents to court. For those that do the potential benefits of bringing an action would be outweighed by the quantum of the costs.*¹⁸

Similar observations were made by the VLRC in its recent report,¹⁹ and it is further reflected by the sheer number of funded class actions proceedings.

The Law Society recognises the clear growth of particular types of class action proceedings in Australia. For example, over the past 25 years shareholder class actions has increased from 12 per cent to 52 per cent of all class action claims.²⁰ It

⁸ *Ibid.* [3.6].

⁹ *Ibid.* [3.25].

¹⁰ *Ibid.* [3.42].

¹¹ *Ibid.* [3.43].

¹² *Ibid.* [3.49].

¹³ *Ibid.* [3.51].

¹⁴ *Ibid.* [3.56].

¹⁵ *Ibid.* [3.62].

¹⁶ *Ibid.* [3.65].

¹⁷ [2016] FCA 1194, [51].

¹⁸ (2007) 111 ALR [34]. Justice Beach made similar comments in *Newstart 123 Pty Ltd v Billabong International Ltd* [2016] FCA 1194 at [51].

¹⁹ Victorian Law Reform Commission, *Access to Justice – Litigation Funding and Group Proceedings*, Report (2018), [2.128], 36.

²⁰ Jason Betts, *The Australian* (11 May 2018).

also recognises the economic appeal for funders to invest in class actions,²¹ as at least \$3.5 billion has been paid by respondents in class action settlements approved by the courts.²²

The growth in class action proceedings together with the high demand and financial benefits to fund such proceedings requires regulation to manage the concomitant risks to class members. One form of regulation is the introduction of a licencing regime, which is proposed by the ALRC in Chapter 3 and discussed below. The Law Society notes that, as a general principle, regulation should only be imposed where it is necessary, and only to the extent necessary. Consistent with the views of the ALRC, the Law Society also notes that a licencing regime cannot, in and of itself, ensure compliance.²³

Proposal 3-1

In his recent reasons for judgment in *GetSwift*,²⁴ Justice Lee traced the history of developments in Australia's federal, representative proceedings structure and identified a number of key matters, including:

- That the types of proceedings brought under Part IVA of the *Federal Court of Australia Act 1976* (Cth) has changed over the years. Justice Lee sets out in a table, statistics gathered by Professor Morabito on substantive claims advanced in funded Part IVA proceedings filed between 1992 and 3 March 2018.²⁵ Evident from this table is the prominence of claims by shareholders and investors, which together, amount to just under three quarters of all class actions brought in the Federal Court in the 16 year period since Part IVA became law.
- The use of an external funder for applicants in class actions has both increased and developed over the same period.
- At the same time, there have been a number of other significant developments, including the recent development of using funding equalisation orders or a "common fund order" to deal with class members who are not parties to a funding agreement.

The decision in *GetSwift* was made in the context of Justice Lee having to grapple with how to case manage three competing class actions brought in the Federal Court relating to essentially the same subject matter by the same class members who were seeking relief in relation to the same causes of action. This issue of competing class actions is an important one. It is considered by the ALRC in Chapter 6 of the Discussion Paper and these submissions deal with it below.

As mentioned above, the use of external funding in class actions is important as the use of funding can assist the bringing of proceedings that might not otherwise be able to get off the ground. However, such funding also presents challenges to the integrity of the administration of justice. Injected into the usual position of lawyers, owing fiduciary duties to their clients in an adversarial context who are officers of the court, is

²¹ Jason Betts, David Taylor and Christine Tran, 'Litigation Funding for Class Actions' in Damian Grave and Helen Mould (eds) *25 Years of Class Actions in Australia* (The Ross Parsons Centre of Commercial Corporate and Taxation Law, Publication 19), 205, 227.

²² The Honourable Justice Bernard Murphy and Vince Morabito, 'The First 25 years: Has the Class Action Regime hit the Mark on Access to Justice?' in Damian Grave and Helen Mould (eds) *25 Years of Class Actions in Australia* (The Ross Parsons Centre of Commercial Corporate and Taxation Law, Publication 19), 13, 22.

²³ Australian Law Reform Commission, *Inquiry into Class Action Proceedings and Third-Party Litigation Funders*, (DP 85), 2018, [3.29].

²⁴ [2018] FCA 732.

²⁵ [2018] FCA 732, [24].

an entity with purely commercial interests. This introduces tensions, including considerable potential for conflicts of interest. Conflicts of interest are dealt with in Chapter 4 of the ALRC Discussion Paper and are discussed below.

One notable feature of securities class actions, as pointed out by Justice Lee in *GetSwift*,²⁶ is that to date, no securities class action has proceeded to judgment. There is a common expectation, (indeed it is an expectation that Justice Lee relies upon in his reasons), that such an action will settle and may involve the payment of substantial compensation. In those circumstances the interests of the class members need particular protection when a funder is involved.

The ALRC recognises that any settlement must be sanctioned by the court, but does not consider this fact sufficient to ensure the appropriate regulation of litigation funders, stating:

*The courts are regulating the funder through the prism of the funder's impact on the particular litigation before the courts. The courts have limited capacity to view the totality of a funder's commitments to litigants at any given time and much less so over time. The courts cannot directly supervise litigation funders for the proper adherence to good governance and legal compliance more generally. The licensing regime can do this, particularly through the auditing requirements.*²⁷

The Law Society agrees with the conclusion in the Discussion Paper that the fact that lawyers are heavily regulated, subject to fiduciary duties to their clients, and owing a primary duty to the court, does not mean that funders should be free from regulatory supervision or that the current arrangements are sufficient and effective.

Funding representative proceedings is often a critical matter to both their commencement and their continuation. Accordingly, a regulatory system that protects class members and the integrity of the judicial system, while at the same time not overly burdening potential funders, is important.

Traditionally, funding of litigation was seen as an abuse of process. In 2006, in *Campbells Cash and Carry Pty Limited v Fostif Pty Limited*,²⁸ the High Court, in the context of representative proceedings in the Supreme Court of New South Wales, concluded that there was no general rule of public policy that defeated the use of funding arrangements in the circumstances of that case. Gummow, Hayne and Crennan JJ, said as follows:

*... if there is a particular aspect of the problem that is to be observed principally in actions where a plaintiff represents others, that is a problem to be solved, in the first instance, through the procedures that are employed in that kind of action.*²⁹

²⁶ [2018] FCA 732 [8].

²⁷ Australian Law Reform Commission, *Inquiry into Class Action Proceedings and Third-Party Litigation Funders*, (DP 85), 2018, [3.28].

²⁸ (2006) 229 CLR 386.

²⁹ (2006) 229 CLR 386.

The Law Society agrees with the observations of the ALRC in the Discussion Paper³⁰ that while the Federal Court plays an essential role in the regulation of litigation funders, the role and powers of the courts are not sufficient to regulate their conduct.³¹

The Law Society also agrees that the action taken in 2013 to exempt litigation funders by regulation from the requirement to hold an AFLS, provided that they have appropriate processes to manage conflicts of interests, has imposed some obligations on funders, but only of a minimum kind.

Observed from a purely commercial perspective, a litigation funder is essentially using a chose in action, held by the members in the class, to seek to make a profit. As such, they are providing a type of financial product. The Law Society supports the view that litigation funders should be under particular regulatory obligations that are enforceable against them.

The Law Society believes that licencing can be a powerful regulatory tool due to the threat of a licence being revoked, its terms being modified or of an investigation being commenced in the event that a licence holder fails to meet or adequately satisfy ongoing conditions of a licence. Accordingly, if a licencing regime is introduced, both the conditions of the licence and the form of the regime require careful consideration. These matters are raised by the proposals and questions of the ALRC, which are discussed below.

The Law Society is particularly concerned with the apparent increase in foreign litigation funders and the difficulties of regulating foreign entities that operate across jurisdictions.³² In addition to any minimum licencing requirements implemented at the national level for litigation funders, the Law Society supports the ALRC's concerns over regulating of foreign litigation funders.

While the Law Society agrees with including an exemption from Australian licencing requirements for foreign funders where they satisfy comparable licencing requirements in their home jurisdiction, it suggests that consideration should be given to the definition of "comparable" and how the adequacy of these licencing regimes are measured. It would be important to ensure that foreign funders were not subject to less stringent requirements than local funders.

In each case, the terms of a funding agreement are critical. The conditions attached to a funding licence, and mandated by statute, should require the form and content of funding agreements to:

- be drafted in plain English;
- clearly set out the degree of control held by the funder over the control of the litigation;
- describe the processes for managing conflicts;
- identify the total commission and any other fees payable; and
- describe the risks faced by the lead applicant and group members.

Proposal 3-2

³⁰ Australian Law Reform Commission, *Inquiry into Class Action Proceedings and Third-Party Litigation Funders*, (DP 85), 2018, [3.28].

³¹ See clause 5 of the Federal Court of Australia's Class Action Practice Note (GPN-CA).

³² Australian Law Reform Commission, *Inquiry into Class Action Proceedings and Third-Party Litigation Funders*, (DP 85), 2018, [3.61].

Proposal 3-2 by the ALRC sets out seven matters, which should be required of a funder who holds a licence. The Law Society agrees that each of these matters is of importance. Taking each in turn, the Law Society comments as follows:

The funder should do all things necessary to ensure that their services are provided efficiently, honestly and fairly

Given that the funder is providing, in practical terms, a financial product, it is difficult to argue that a funder should not be under an obligation to provide their services "efficiently, honestly and fairly". It is not necessary that a funding agreement requires a funder to exercise such obligations and, even if implied, they could be excluded in a funding agreement. There is currently some doubt over the powers of the Federal Court to amend or vary a funding agreement, which is discussed below in relation to Chapter 5.

The funder should ensure all communications with class members and potential class members are clear, honest and accurate

It is difficult to object to this obligation. Clarity, honesty and accuracy should be hallmarks of any provider of financial services or products.

The funder should have adequate arrangements for managing conflicts of interests

Managing of conflicts of interests is essential and is currently required by the *Corporations Regulation*. This is considered in more detail below in the discussion in relation to Chapter 4 of the ALRC Discussion Paper.

The funder should have sufficient resources (including financial, technological and human resources)

The ALRC argues that litigation funding is broadly analogous to insurance arrangements and managed investment schemes.³³ A key regulatory requirement for an insurer is to have adequate capital so that it can meet all claims. Similarly, it is important that any litigation funder will have sufficient resources both to properly resource the particular requirements of the class members and also to not put itself in the position where any financial or other difficulties may compromise its obligations.

The funder must have adequate risk management systems

It is important, particularly where funders may be undertaking funding in a number of disputes, that they have sufficient systems to ensure that financial risks are properly identified and managed. The enforcement of adequate risk management systems could mitigate, or at least expose, the potential risks of plaintiffs being left without funding. For example, in 2013 a law firm brought a class action regarding the NSW equine influenza break in 2007 affecting the horse racing industry.³⁴ This action was funded by a UK funder, which was later revealed to be associated with a Ponzi scheme. This led the law firm to terminate its funding arrangements with the funder. Because that firm was large, the proceedings were not affected by the financial inadequacies of the funder. However it has been suggested that the firm was left significantly out of pocket.³⁵

³³ Australian Law Reform Commission, *Inquiry into Class Action Proceedings and Third-Party Litigation Funders*, (DP 85), 2018, [3.26].

³⁴ 'Litigation Funding for Class Actions' in Damian Grave and Helen Mould (eds) *25 Years of Class Actions in Australia* (The Ross Parsons Centre of Commercial Corporate and Taxation Law, Publication 19), 205, 227.

³⁵ M Papadakis, "Maurice Blackburn \$11 million out of pocket after failed equine flu class action", *Australian Financial Review* (16 June 2016), referred to by Jason Betts, David Taylor and Christine Train in 'Litigation Funding for Class Actions' in Damian Grave and Helen Mould (eds) *25 Years of Class Actions in Australia* (The Ross Parsons Centre of Commercial Corporate and Taxation Law, Publication 19), 205, 224.

The Law Society notes that while there have been limited examples of this occurring, in light of the rapid growth of litigation funding, if left unregulated, the potential for serious harm exists.

The funder must have a compliant dispute resolution system

The Law Society agrees that a dispute resolution system that would not involve the expense and difficulties of adversarial proceedings is important and that a model might be based on the system that applies in relation to Australia's financial system.³⁶

The funder should be audited annually

The Law Society agrees that there should be an annual auditing requirement. Further, it is essential that the auditor be entirely independent of the funder.

Questions 3-1, 3-2, and 3-3.

The Law Society supports the introduction of minimum requirements for character and qualifications.

Character. We note with approval the character requirements that apply to AFSL holders.

Qualifications: Qualification requirements should cover (a) the necessary financial skills required to operate a funding business and (b) the legal skills to understand civil litigation, including relevant court rules practices and procedures. Detail would need to be provided in relation to both elements.

The Law Society supports the application of the AFSL financial standards requirements to litigation funders.

The Law Society supports the suggestion that funders be required to join the Australian Financial Complaints Authority (AFCA) scheme. As acknowledged by the ALRC in its Discussion Paper,³⁷ there is some detail that would need to be worked out, such as the circumstances in which consumers could seek access to AFCA.

Chapter 4: Conflicts of interest

The potential for conflicts of interests and duty for both lawyers acting for representative members in class actions and litigation funders is particularly acute. The Law Society also notes that the Law Council of Australia is currently undertaking a review of the Australian Solicitors' Conduct Rules.

In Chapter 4 of its Discussion Paper, the ALRC identifies a number of potential conflicts of interest that may arise in the class actions context. Following an analysis of these potential conflicts, the ALRC reached a number of conclusions, including:

- Solicitors practicing in class actions should receive accreditation through a continuing education program.³⁸
- Prospective class members should receive information regarding actual and perceived conflicts at the first available opportunity.³⁹

³⁶ Australian Law Reform Commission, *Inquiry into Class Action Proceedings and Third-Party Litigation Funders*, (DP 85), 2018, [3.64]-[3.68].

³⁷ *Ibid.* [3.68].

³⁸ *Ibid.* [4.3].

³⁹ *Ibid.* [4.4].

- If the licensing regime recommended in Chapter 3 of the Discussion Paper is not adopted, further action may be required by litigation funders to avoid and manage conflicts of interest.⁴⁰
- Solicitors and law firms should be prohibited from having an interest in litigation funding entities that are funding the very proceedings being conducted by the solicitor/law firms.⁴¹

This response deals with each of these matters in turn.

Proposal 4-1

The ALRC's primary position is that there should be a licensing regime for litigation funders, as outlined above. The alternative option suggested by the ALRC is that further action is required for litigation funders to avoid and manage conflicts of interest. The Law Society notes that a number of arguments against introducing further regulation of litigation funders are based on concerns with "over-regulation" and the imposition of unnecessary restrictions in the market and competition.⁴² However, these arguments are, in the view of the Law Society, outweighed by the risks and consequences of unmanaged conflicts of interest.

The ALRC notes that in 2009 the Full Federal Court of Australia found that the litigation funding arrangements under consideration constituted a "managed investment scheme".⁴³ Further, in 2011 the NSW Court of Appeal found that a litigation funding arrangement was a "financial product" under s 763A of the *Corporations Act 2001* (Cth).⁴⁴ On appeal, the High Court of Australia held that the funder in that case was a "credit facility".⁴⁵

In response to these findings, the Commonwealth Government in 2012 exempted "funders" from the definition of "managed investment scheme", but only on the condition that funders had necessary processes in place to manage conflicts of interest. Exempt litigation funders are subject to the Australian Securities Investments Commission (ASIC) Regulatory Guide 248.

The ALRC notes that it has received competing submissions as to whether the ASIC Regulatory Guide 248 is sufficient to regulate litigation funders. The ALRC identifies some troubling matters,⁴⁶ namely that there is no way to determine whether funders are following the ASIC Regulatory Guide 248. It also notes that there is little oversight or action from ASIC in this context.

The Law Society is concerned with the adequacy of an ASIC Regulatory Guide to effectively manage the potential risks of conflicts of interests and also regulate litigation funders in this context without other regulatory tools to enforce compliance. As noted by the VLRC, whilst the courts play a role in supervising litigation funders in legal

⁴⁰ Australian Law Reform Commission, *Inquiry into Class Action Proceedings and Third-Party Litigation Funders*, (DP 85), 2018, [4.5].

⁴¹ *Ibid.* [4.6].

⁴² See for example, submissions to the Victoria Law Reform Commission, *Access to Justice – Litigation Funding and Group Proceedings*, Report (2018) 19 [2.30], including Submission 3 (Julie-Anne Tarr) and Submission 28 (Slater and Gordon Lawyers).

⁴³ [4.14] of the Discussion Paper citing *Brookfield Multiplex Limited v International Litigation Funding Partners Pte Ltd* (2009) 180 FCR 11.

⁴⁴ *International Litigation Partners Pte Ltd v Chameleon Mining NL* (2011) [NSW CA 50]

⁴⁵ *International Litigation Partners Pte Ltd v Chameleon Mining NL (Receivers and Managers appointed)* (2012) 246 CLR 455. See also [4.15] of the Discussion Paper.

⁴⁶ Australian Law Reform Commission, *Inquiry into Class Action Proceedings and Third-Party Litigation Funders*, (DP 85), 2018, [4.34] and [4.36].

proceedings, they can only do so on a case by case basis,⁴⁷ and the role therefore is limited in several respects.

At the very least, the Law Society agrees with the ALRC that there should be a requirement to regularly report to ASIC.

Proposal 4-2

The ALRC referred to new methods of litigation funding, such as “law firm financing” or “portfolio funding”. Proposal 4-2 recommends that these methods of funding be included within the definition of a “litigation scheme” in the *Corporations Regulations*. The Law Society agrees with this recommendation.

Proposal 4-3

The Law Society agrees that specialist accreditation for solicitors in the law and practice of class actions could be developed. The use of accreditation is not only of utility for solicitors, but is also important for consumers of legal services. This is particularly relevant in a market where consumers may be vulnerable and where the potential for conflicts of interests is acute.

The potential for conflicts and the importance of lawyers understanding their legal and ethical obligations in the context of class actions is crucial. It is a specialised area and can be particularly complex when conflicts and ethical duties are in being considered.

However, the Law Society notes that existing specialist accreditation is not a requirement for a practitioner to undertake certain matters, and this should also be the case for class actions. Accreditation for class actions should be a matter of choice for practitioners, and, in accordance with other specialist accreditation, should only be available to those for whom class actions are a significant part of their practice, generally 25%.

The Law Society of NSW will consider whether there is sufficient demand for potential specialisation within its existing Specialist Accreditation program. ‘Class action practice’ may be a sub category in the Commercial Litigation program or a newly designed program.

Proposal 4-4

At [4.63] of the Discussion Paper, the ALRC refers to a case in which a law firm initially sought court approval to have a related entity fund the class action but then withdrew that application.⁴⁸

The Law Society generally supports the implementation of legislative guidance for lawyers, particularly to manage potential conflicts of interest. As noted by the VLRC, such guidance for lawyers is particularly important in class actions, given “the complexity of issues involved”.⁴⁹ It is also important that any guidance is consistent between the states so that it applies to all lawyers involved in Australian class action proceedings.

The Law Society notes the ALRC's proposal that the Australia Solicitors' Conduct Rules should be amended to expressly prohibit solicitors from being invested in the

⁴⁷ Victorian Law Reform Commission, *Access to Justice – Litigation Funding and Group Proceedings*, Report (2018), [2.21].

⁴⁸ *Clasul Pty Ltd v Commonwealth of Australia* [2014] FCA.1133.

⁴⁹ Victorian Law Reform Commission, *Access to Justice – Litigation Funding and Group Proceedings*, Report (2018), [4.138].

outcome of a funded matter in which they are acting through having an interest in that litigation funder.⁵⁰ The Law Society supports consideration of this proposal because it believes that it is in the interests of the administration of justice that lawyers should not be put in a position where they would have, potentially, a clear and inherent conflict between commercial interests, through a funding vehicle, and exercising their fiduciary duties in favour of parties to the litigation that is being funded by that vehicle. While it is true that lawyers manage conflicts of interest on a regular basis, it is the view of the Law Society that it would not be in the public interest for lawyers to be able to place themselves in such a position of potential and perceived conflict.

Proposal 4-5

The ALRC proposes that the Australian Solicitors' Conduct Rules should also be amended to require disclosure of third-party litigation funding in any dispute resolution proceedings, including arbitral proceedings.

The importance of the use of arbitration in dealing with legal disputes is growing at both the national and international level. A compelling reason in support of this proposal is that disclosure of such arrangements may prevent conflicts emerging that would otherwise embarrass a mediator, arbitrator or judicial officer.⁵¹ The Law Society further highlights the importance of regulating conflicts arising due to the limited, or in some cases, lack of, judicial oversight. As indicated by a number of submissions made to the VLRC, this can affect and increase the reliance of parties to funded litigation on the courts to protect their interests.⁵²

Proposal 4-6

Clearly delineating the obligations of legal representatives and funders, together with early disclosure of conflicts of interests, is beneficial to both class members and the court in class action proceedings. This point was made by the VLRC in its recent report, as follows:

*By increasing transparency, accountability improves. The client is better informed about the conditions under which the funding is provided and implications for the way the litigation is conducted. The court is better able to identify any impact that a conflict of interest may be having on the proceedings and the terms of any settlement.*⁵³

In its Discussion Paper, the ALRC observes that information about conflicts may be relevant to the decision by a potential class member to opt out of proceedings. For this reason, the ALRC recommends that the Federal Court of Australia's Class Action Practice Note (GPN-CA) should be amended so that the first notice sent to potential class members by legal representatives (whatever the reason for that notice) describes the respective obligations of the legal representatives and the litigation funders to avoid and manage conflicts of interest. That notice should also identify and outline the details of any potential conflicts of interest that may arise in a particular case.

The Law Society agrees that this is a sensible proposal. The decision by a potential class member to opt out of proceedings is the most important decision they may make. If a class member does not opt out they may receive few communications before the

⁵⁰ Australian Law Reform Commission, *Inquiry into Class Action Proceedings and Third-Party Litigation Funders*, (DP 85), 2018, [4.64].

⁵¹ *Ibid.* [4.66].

⁵² Victorian Law Reform Commission, *Access to Justice – Litigation Funding and Group Proceedings*, Report (2018), [2.13].

⁵³ *Ibid.* [2.118].

proceedings are ultimately settled. It is therefore important that potential class members are made aware of potential conflicts and that those matters are explained clearly and plainly to them from an early stage of the proceedings.

In addition to improving a class member's understanding of any potential conflicts, a notice could also include a clearer outline of the class action proceeding, which would address some of the difficulties members currently experience in understanding the complex nature and issues of the class action.⁵⁴

Chapter 5: Commission rates and legal fees

In Chapter 5, the ALRC considered the introduction and concomitant issues of contingency fees for class action proceedings, commissions payable to third-party litigation funders and potential statutory limitations in relation to such arrangements.

Proposals 5-1 and 5-2

The ALRC proposes that contingency fee arrangements for solicitors should be permitted in Australian class action proceedings and suggests that there should be some controls in place, including:

- seeking leave of the court to enter a contingency arrangement;
- where there is a contingency fee agreement, direct funding by a litigation funding entity on a contingency basis is impermissible;
- a contingency fee cannot be recovered in addition to professional fees for legal services charged on a time-cost basis; and
- if there is a contingency fee agreement, solicitors must advance the cost of disbursements and indemnify representative class members against an adverse costs order.

The introduction of contingency fees would be a significant change to the Australian legal landscape, and the Law Society notes the range of views held by its members.

Some members of the Law Society expressed concern about the proposal to prohibit contingency fees where a matter is funded by a litigation funder. Also, the Law Society does not support reforms that would require a solicitor to be solely liable for disbursements or adverse costs where there is a contingency fee arrangement.

The Law Society notes that the introduction of contingency fee arrangements would raise conflict of interest concerns, and while the court may play a role in reviewing such arrangements, this could only ever be a limited safeguard.

On balance, the Law Society does not support the permission of contingency fees for solicitors.

Proposal 5-3

As identified by the ALRC,⁵⁵ there is a level of doubt as to the power of the Federal Court to make orders varying the contractual arrangements between the funder and class members.⁵⁶

⁵⁴ Victorian Law Reform Commission, *Access to Justice – Litigation Funding and Group Proceedings*, Report (2018), see the discussion at [4.218]-[4.224].

⁵⁵ Australian Law Reform Commission, *Inquiry into Class Action Proceedings and Third-Party Litigation Funders*, (DP 85), 2018, [5.50]-[5.51].

⁵⁶ See, eg, *Blairgowrie Trading Ltd v Allico Finance Group Ltd (recs and mgrs) (in liq) (No 3)* (2017) 343 ALR 476, [110]; *Clarke v Sandhurst Trustees Limited (No 2)* [2018] FCA 511, [12], [18].

It is the Law Society's view that any doubt about the existence of this power should be removed by statutory amendment. It should be made clear that the court in supervising representative proceedings has the capacity to vary or reject the terms of agreements between funders and class members. That is consistent with the suggestion made by the ALRC.⁵⁷

If contingency fee arrangements were to be made legal for class actions proceedings, the Law Society suggests that they need to be considered in the context of the regulation of external litigation funding. If the Federal Court has the power to, and is required to, approve a contingency arrangement, it should also have the power to modify or amend that arrangement.

The Law Society also suggests that it would be preferable that the terms of any external funding agreement be viewed and be subject to approval by the court during the early stages of proceedings. That approval could be provisional and subject to later change. Consideration at an early stage is likely to be in the interests of the class members rather than conducting a review only at the end of the process. If arrangements have been reviewed at an early stage there may be less need to consider their modification at a later stage.

Indeed, this is what has, albeit indirectly, occurred in the case of the funding arrangements in the *GetSwift* litigation. In giving close consideration to the management of potentially competing claims, Justice Lee considered the nature of the alternative funding arrangements in the three sets of proceedings before him as relevant and important. While giving close consideration to a number of matters, his Honour stayed two of those proceedings and allowed the third proceeding to go forward, which in his view, had the most attractive funding mechanism.

Questions 5-1, 5-2 and 5-3

Limitation on types of proceedings

It can be argued that contingency fees have the capacity to encourage an increase in the occurrence of smaller representative claims, which might be a positive in respect of ensuring access to justice.

However, the prohibition on contingency fees exists to ensure that plaintiffs do not see the returns from their claim consumed by excessive legal fees. A clear example of this risk is evident in the case of *Fitzgerald & Anor v CBL Insurance Ltd (No. 2) (Hun)*,⁵⁸ considered by the VLRC. In Hun, the former trustees of Hun Corporation, suing CBL Insurance Ltd, would have been unable to bring the action without funding, but the high rates of commission charged and significant legal fees meant that the trustees "ultimately received nothing from the amount awarded".

Accordingly, the Law Society considers that it would be unlikely for contingency fees to improve access to justice, as the smaller claims are the most likely to be consumed by contingency fees.

The ALRC, in contemplating contingency fees, observes that at least certain types of class action matters may be unsuitable for contingency fees. The ALRC provides the

⁵⁷ Australian Law Reform Commission, *Inquiry into Class Action Proceedings and Third-Party Litigation Funders*, (DP 85), 2018, [5.52].

⁵⁸ [2015] VSC 493 (2 October 2014).

example of personal injury matters which is based on “the limitations on the quantum of damages that can be recovered”.⁵⁹

While shareholder class actions often involve substantial claim sizes, other claims may have lower returns and therefore be more at risk of the circumstances which arose in Huon.

Statutory limitations and caps (Questions 5-2 and 5-3)

Some Judges have raised concerns as to the proportion of settlements being paid in legal costs and to funders. In some cases, although the court has approved the settlement, it expressed some disquiet. Some of these matters are referred to by the ALRC in the Discussion Paper.⁶⁰

The Law Society is also concerned that the proportion of settlement payments absorbed in legal fees and funding commission rates is often very significant and that current law and practices may not be best promoting the interests of class members.

In *Clarke v Sandhurst Trustees Limited (No 2)*,⁶¹ Justice Lee approved, with some reluctance, a settlement where out of the proposed settlement sum of \$16.85 million there needed to be deducted legal costs of approximately \$5 million and funding commission rates of approximately \$5 million. Justice Lee referred to the evidence of the Chief Executive Officer of the funder in the proceedings, to the effect that it was her experience that it was “not unusual for group members to not receive 50% of the proceeds but the settlement is approved by the court as fair and reasonable”.⁶² While Justice Lee suggested that that evidence did not accord with his experience, the Law Society is concerned that a funder in this industry is of the general belief that payments made in settling class actions can be fair and reasonable, notwithstanding that they constitute less than 50% of the proceeds. A further concern is that this might appear to be the norm.

In another recent case, *Caason Investments Pty Ltd v Cao (no 2)*,⁶³ a settlement involving a payment of \$19.25 million (inclusive of costs) was approved by the court,⁶⁴ with legal costs and disbursements of over \$8 million⁶⁵ and commission payable to the funder of over \$6 million (based on a common funding order at a commission rate of 30% of the gross recovery).⁶⁶

The Law Society does not question the application by the court in each of these cases of the correct principles. However, it is concerned at the proportionality of returns to class members and the totality of legal fees and commissions payable to funding entities. The Law Society accepts that each case needs to be determined on its own facts and that many complexities are involved. It would be glib and incorrect to make a blanket statement that returns to class members are too small. Having said that, the Law Society is concerned that the court has a sufficient armoury of powers and management techniques at its disposal to properly evaluate the level of fees and commissions in any given case.

⁵⁹ Australian Law Reform Commission, *Inquiry into Class Action Proceedings and Third-Party Litigation Funders*, (DP 85), 2018, [5.42].

⁶⁰ Australian Law Reform Commission, *Inquiry into Class Action Proceedings and Third-Party Litigation Funders*, (DP 85), 2018, [5.55]-[5.62].

⁶¹ [2018] FCA 511.

⁶² [2018] FCA 511, [28].

⁶³ [2018] FCA 527.

⁶⁴ [2018] FCA 527, [3].

⁶⁵ [2018] FCA 527, [10].

⁶⁶ [2018] FCA 527, [165].

Further, the Law Society accepts that while the court may have the benefit of a costs expert, a referee and, in some cases, submissions by an amicus curiae/contradictor, additional measures could be put in place to protect the interests of class members, such as statutory limitations and caps.

The ALRC has raised the issue of potentially capping legal fees and commission rates.

The ALRC refers to the position taken by the Productivity Commission⁶⁷ and in England and Wales.⁶⁸ The Productivity Commission identified four matters that it said might be advanced in opposition to the use of statutory caps:

- A sliding scale statutory cap may result in payments disproportionate to work or risk (and this could work both ways).
- The maximum cap may become the default amount awarded to solicitors or funders.
- The introduction of statutory caps may affect the viability of pre-existing litigation funders whose business models rely on varying commission rates related to risk and other commercial considerations. This may mean that there are fewer new entrants.
- The introduction of caps may dissuade solicitors from taking on the types of cases that contingency fees might promote – namely, smaller matters with higher risk.⁶⁹

These comments need to be seen in a setting where the court has the power, or at least considers that it has the power, to vary funder commission rates. If contingency fees were to be introduced, the Law Society agrees with the recommendation that a correlative power should exist. The question then is whether the exercise of such powers and, the discretions that can be exercised, acting judicially, are sufficient to ameliorate the potential risk of payments to funders and lawyers that are so significant and disproportionate so as to undermine faith in representative class proceedings.

The Law Society addresses the points raised by the Productivity Commission in turn, as follows:

- While caps can be a blunt instrument, the statutory cap could have a built-in safety valve, namely making the cap subject to variation by the court if good reason is shown. This would then cast the onus on the person applying for a variation to establish that in the particular case the cap was not operating effectively.
- Similarly, in relation to the risk that a cap may become the default amount, the court could be given a residual discretion to vary a funding arrangement by reducing the commission payable so that it fell at some appropriate point well below the cap.
- The Law Society doubts that the business models of funders would be so affected that people would not be willing to enter this market, provided that a cap is set at a sensible, commercial level.
- Provided that the cap is set at a reasonable level, solicitors would not be dissuaded from commencing proceedings. Further, if in a particular case there is a high risk associated with success, then solicitors should think quite carefully about all those risks before being prepared to commence such proceedings, rather than launching very risky proceedings in the event that they may pay off with a high return to them.

⁶⁷ Australian Law Reform Commission, *Inquiry into Class Action Proceedings and Third-Party Litigation Funders*, (DP 85), 2018, [5.66]-[5.68].

⁶⁸ *Ibid.* [5.69].

⁶⁹ *Ibid.* [5.70]-[5.73].

As an alternative to a statutory cap, the ALRC asks whether there should be a rebuttable presumption that the maximum proportion of fees and commissions paid for any one settlement or judgment sum is 49.9%.⁷⁰

The Law Society suggests that consideration could be given to introducing a combination of caps and a rebuttable presumption of a maximum proportion, coupled at all times with a residual discretion in the court to alter arrangements if it is in the interest of class members to do so. A further consideration would be to limit the return to the funder to a proportion of the proceeds after legal fees have been withdrawn, rather than a proportion of the total amount awarded.

Finally, if caps were to be introduced they should perhaps be subject to automatic review, say after five years, to assess their operation.

Lawyers' fees and hourly rates – some general comments

In a number of cases the courts have questioned the totality of legal fees charged and payable as part of a settlement. In such cases, the courts have used experts and referees at the settlement approval stage to attempt to gauge whether the fees are fair and reasonable.

The Law Society sees some merit in the procedure endorsed by Justice Lee in *GetSwift*. In that case, the arrangements governing the proceedings that were allowed to proceed include a procedure involving a referee conducting periodic reviews of the accounts issued by the lawyers. This suggestion was described by Justice Lee as “novel”.⁷¹ In the Law Society’s view this procedure, or an analogous one, may have some merit in some cases. Indeed, having an experienced referee monitor accounts on a regular basis would enable them to get better acquainted with the running course of the dispute and thus also enable that person to be of better assistance to the court when it came to the settlement approval stage.

Further, in the case of representative proceedings, such as in proceedings involving alleged continuous disclosure breaches where losses by individual shareholders may be quite small, and where the class members have no realistic economic capacity to bring proceedings, any settlement sum which is ultimately payable to them is likely be seen as gratefully received. As such, there is no real transparency or ability for those class members to analyse whether the result is a good one from their perspective. That highlights two points:

1. the utility of representative proceedings; but also
2. the heightened necessity for close scrutiny by the court of:
 - i. all the arrangements by lawyers acting for plaintiffs in representative proceedings; and
 - ii. all the funding arrangements, to ensure that justice is both done and seen to be done.

Issues relating to costs and commissions are also closely related to the potential for multiple class actions and the waste and unnecessary use of resources that that in itself may entail. This is dealt with in the response by the Law Society to Part 6 of the Discussion Paper.

A view of some members of the Law Society is that the existence and proliferation of multiple class actions provides an opportunity to bring more competitive tension into

⁷⁰ Australian Law Reform Commission, *Inquiry into Class Action Proceedings and Third-Party Litigation Funders*, (DP 85), 2018, [5.76].

⁷¹ *GetSwift* [2018] FCA 527, [127].

the selection of both lawyers (and their rates) and funders (and their commissions and other contractual terms) and the arrangements by which the lawyers and funders operate together as a common enterprise.

Question 5-4

The Law Society has no comment in relation to this question.

Chapter 6: Competing Class Actions

Proposal 6-1

It is important that the court has the power and the flexibility to deal with the situation where more than one class action is commenced with overlapping class membership. While the VLRC did not recommend a statutory power to choose one class action over another, the Federal Court has sought to exercise such power (e.g. Lee J in *GetSwift*). Clarity of the existence of the power is desirable.

Issues of multiple actions occur both within Courts (such as in *GetSwift* where there were three actions brought in the Federal Court) and between Courts (such as the actions brought against AMP recently in the Federal Court and the Supreme Court of NSW).

Multiple actions, whatever their situs, is a recipe for confusion, delay and waste in costs and Court time. The Law Society suggests that this problem should be grappled with at a legislative and judicial level with the aim to reduce the existence of competing actions as early in their life as is reasonably possible. The idea of a consolidation proceeding where all actions can be brought together and case managed with one action only to proceed, where that is possible, has great attraction for all participants.

Whenever there is a federal matter involved, there is the capacity to deal with all the actions in a court exercising Federal jurisdiction. No doubt there may be complex issues to consider, such as the cross-vesting legislation, but where it is constitutionally possible to bring disparate actions before one court that can then make any necessary orders, while at the same time respecting comity, waste and inefficiency can be reduced.

However, the Law Society does not support a situation where there must only be one action that progresses, or that all class actions must be open. There are circumstances where it may be in the best interests of separate classes of plaintiffs to proceed separately. There are also circumstances where a law firm may have commenced a closed class action, and have costs agreements in place with the members of that class, and to force that class to become open may create challenges for that firm that were unforeseeable when the action was commenced. In circumstances where there are multiple actions, the courts should be given the flexibility to determine the appropriate structure for matters to proceed.

One of the benefits of the existing regime is its flexibility in being able to respond to the circumstances of the cases being managed and the broad range of procedural issues that can arise. The National Court Framework (NCF) of the Federal Court has been devised so as to allow the Court to apply case management to fit the circumstances of the case at hand and so as to give effect to the overarching purpose (see ss 37M and 37N of the *Federal Court of Australia Act 1976* (Cth)). This facilitates different judges adopting different approaches that are tailored to meet the circumstances of individual cases, rather than being bound to follow a predetermined path that is paved by regulation.

Consistent with that, the VLRC's conclusion in its examination of the question of whether reform is necessary to assist the Court in addressing competing class actions, is instructive:

Given the case-dependent approach adopted by the courts to date, the Commission does not consider it necessary to give the Court express legislative power to choose one class action when competing proceedings are filed. It would be unlikely to provide any real change to practice, and may risk a 'one size fits all' approach being adopted, which the Federal Court has cautioned against.⁷²

The VLRC therefore recommends that the better solution (rather than class certification and by analogy, a mandatory stay) is for better guidance to be given to the Court and parties:

The Supreme Court should consider amending its practice note on class actions to include guidance for the Court and parties on managing competing class actions. The guidance should reflect current practice, as it has developed over time, and allow for the Court to respond flexibly in the circumstances of each case.⁷³

This is consistent with Justice Foster's approach in *Cantor v Audi Australia Pty Limited (No 2)* [2017] FCA 1042, at [74]-[75] as endorsed by Justice Lee in *Getswift* at [94], where his Honour said

What the survey of the cases illustrates is a point I made at the commencement of these reasons. That is, at bottom, the remedial response to the issue of overlapping class actions is a case management decision informed by considerations peculiar to the circumstances of the cases which are being managed. I agree with Foster J that one size does not necessarily fit all. There may be circumstances, such as the unusual one that confronted his Honour, where some factors do militate in favour of adopting a 'wait and see' approach or others where allowing a short period for a possible acceptable consensus to emerge would be appropriate...

The ability for class members to opt-out of one group to be part of another group would appear to contribute to an environment of competing actions. One suggestion is that group members who opt-out of one class action not be permitted to commence or participate in subsequent aggregate proceedings against the same defendant in respect of the same subject matter, without leave of the court. The discretion granted provides the capacity for the court to assess, on a case-by-case basis, whether the person is wishing to vindicate their rights, or whether a funder is seeking to avoid the new regime – with the latter being an undesirable outcome.

Finally, if a group proceeding is commenced, a mechanism for ensuring that any other proceedings are also then commenced and brought before one court to be managed, and, if appropriate, for only one proceeding to continue, has much merit. First, it would reduce ongoing cost and complexity. Secondly, such a mechanism may operate to provide competitive tension between lawyers seeking to represent the class and funders wishing to fund the litigation.

⁷² Victorian Law Reform Commission, *Access to Justice – Litigation Funding and Group Proceedings*, Report (2018) [4.85].

⁷³ Victorian Law Reform Commission, *Access to Justice – Litigation Funding and Group Proceedings*, Report (2018) xx [11].

Proposal 6-2

The Law Society supports this Proposal as a general proposition, although an alternative approach is guidance in a practice note, as suggested by the VLRC in their recommendation 11.⁷⁴

The ALRC's proposal for a 'selection hearing' is supported. The Discussion Paper refers at [6.51] to *GetSwift*. The outcome in the interlocutory proceedings demonstrates the merit of the proposal. Justice Lee was able to consider the competing funding and other terms and make a reasoned approach as to which of the three actions was in the greater interest of group members.

While not employed by Justice Lee, the use of a 'contradictor' who would make submissions to the Court as to the competing benefits of each action might be worthwhile.

There are likely to be practical difficulties with some of the ALRC's suggestions – for example, regarding notification to potential claimants and their lawyers and funders that a class action has commenced.⁷⁵ Rather than requiring the claimants to notify alternative potential claimants and lawyers of the commencement of a claim, which is likely to be problematic, the Court should maintain an up-to-date list of current class actions which potential claimants and lawyers may monitor.

Question 6-1

A benefit of conferring exclusive jurisdiction on the Federal Court in respect of matters brought under the *Corporations Act 2001* would be to avoid the expense and delay of applications under the cross-vesting legislation for transfers or for other applications such as stays and requests for anti-suit injunctions.

However, the Law Society notes that the VLRC recommends improving the Court's cross-vesting capabilities in its recommendation 12, as follows:

*The Attorney-General of Victoria should propose to the Council of Attorneys-General that a cross-vesting judicial panel for class actions be established. The judicial panel would make decisions regarding the cross-vesting of class actions, where multiple class actions relating to the same subject matter or cause of action are filed in different jurisdictions.*⁷⁶

The Law Society notes that the ALRC proposal does not extend to all federal matters, and, even if it did, an issue for competing State actions involving no federal matter would remain. Consideration might be given to conferring on the Federal Court exclusive jurisdiction in all federal matters commenced by way of representative proceedings.

Chapter 7: Settlement Approval and Distribution

Proposal 7-1

⁷⁴ Victorian Law Reform Commission, *Access to Justice – Litigation Funding and Group Proceedings*, Report (2018) xx [11].

⁷⁵ Australian Law Reform Commission, *Inquiry into Class Action Proceedings and Third-Party Litigation Funders*, (DP 85), 2018, [6.46].

⁷⁶ Victorian Law Reform Commission, *Access to Justice – Litigation Funding and Group Proceedings*, Report (2018) xx [12].

The Law Society supports this proposal given that the ALRC's suggestion is that the Court "may" appoint a referee, which acknowledges that the appointment of a referee will not always be appropriate and that the power to do so should remain a discretionary power of the court.⁷⁷ Part 15 can be easily amended with the addition of the new power at sub-paragraph 15.4(c).

We note the VLRC makes a similar recommendation:

*The Supreme Court should consider amending its practice note on class actions to provide guidance for the appointment of an independent costs expert by the Court to assist in the assessment of legal costs and litigation funding fees. This should take into account the guidelines contained in the Federal Court practice note on class actions relating to the use of costs experts.*⁷⁸

Question 7-1

Not every settlement should be the subject of a tender, though a tender process may be suitable in some circumstances. Again, an overly rigid and prescriptive approach should be avoided.

In its consideration of settlement administration and distribution the VLRC observed that:

*The Commission asked in the consultation paper how the management of settlement distribution schemes could be improved. The responses observed that the best approach depends on the type of class action, the complexities of the claims involved, and the capabilities of the appointed scheme administrator.*⁷⁹

It should be noted that in common form securities class actions, settlement administration costs are not a significant contributor to costs.

Question 7-2

The Law Society notes that, generally, settlements are made public. In circumstances where the terms are not made public, there is usually a good reason, and the parties tend to be in agreement about that. As such, the Law Society would not support a provision that mandated the publication of settlement terms.

Chapter 8: Regulatory Redress

Proposal 8-1

The ALRC argues that the potential benefits of an enhanced regulatory redress mechanism within Australia warrant the consideration of the establishment of a federal collective redress scheme.⁸⁰ The Law Society is of the view that if any such redress mechanism is introduced, a claimant should be permitted to remain outside the scheme and litigate the claim if they wish.⁸¹

⁷⁷ Australian Law Reform Commission, *Inquiry into Class Action Proceedings and Third-Party Litigation Funders*, (DP 85), 2018, [7.22].

⁷⁸ Victorian Law Reform Commission, *Access to Justice – Litigation Funding and Group Proceedings*, Report (2018) xx [25].

⁷⁹ Victorian Law Reform Commission, *Access to Justice – Litigation Funding and Group Proceedings*, Report (2018) [4.102].

⁸⁰ Australian Law Reform Commission, *Inquiry into Class Action Proceedings and Third-Party Litigation Funders*, (DP 85), 2018, [8.4].

⁸¹ *Ibid.* [8.4].

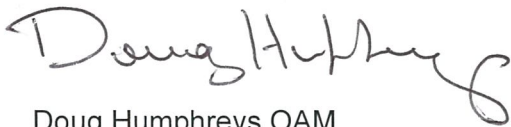
The Law Society notes that it may be difficult to quantify damage in certain types of claims under such a scheme.

Question 8-1

The Law Society does not have any comment on this question.

Please do not hesitate to contact Mark Johnstone, Director, Policy and Practice on 02 9926 0256 or at mark.johnstone@lawsociety.com.au if you would like to discuss this in more detail.

Yours sincerely,

A handwritten signature in black ink that reads "Doug Humphreys". The signature is written in a cursive, flowing style.

Doug Humphreys OAM
President