Maurice Blackburn Lawyers

Since 1919

SUBMISSION TO THE AUSTRALIAN LAW REFORM COMMISSION

Inquiry into Class Action Proceedings and Third-Party Litigation Funders

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ABOUT MAURICE BLACKBURN

Maurice Blackburn is a plaintiff litigation firm with 32 permanent offices and 31 visiting offices throughout all mainland states and territories. We employ more than 1,000 staff nationally, including approximately 330 lawyers who provide advice and legal assistance to thousands of clients each year.

In addition to specialised practice areas in personal injuries, medical negligence, employment and industrial law, dust diseases, superannuation and financial advice disputes, Maurice Blackburn has the largest and most experienced class actions practice in Australia. We currently act in around 20 class actions that are active and ongoing at various procedural stages (including settlement administration) in the Federal Court of Australia and also in the Supreme Court of Victoria and the Supreme Court of NSW.

Since the establishment of our class actions practice in 1998, we have acted in more class actions than any other plaintiff law firm,[1] and we have obtained more than $2.6 billion in compensation for class members in a range of different class actions including shareholder and investor cases, product liability claims, consumer actions, cartel cases and mass tort claims. Our track record in achieving compensation accounts for approximately 70% of all monetary compensation that has been achieved for class action claimants in Australia.

We have observed and been active participants in the development of class actions practice and jurisprudence since the infancy of the regime in Part IVA of the *Federal Court of Australia Act 1976* (Cth). We acted for the representative plaintiffs in the earliest class actions that involved third party litigation funders and since then we have worked with numerous domestic and international litigation funders as the funding industry and funding practices developed over time. Our firm also conducted the earliest shareholder class actions, and this type of class action continues to be a significant part of our practice.

GENERAL COMMENTS AND SUMMARY

Victims of mass wrongs have been well served by the Part IVA regime and its state based analogues, which have achieved their intended purpose of enabling access to justice and delivering compensation to scores of individuals and companies in circumstances where they would otherwise have been denied the opportunity for redress.

The fears and misgivings of opponents of the introduction of Part IVA have not been manifested – far from being "legally sanctioned mob vengeance for imaginary wrongs",[2] or inspiring a litigious culture or otherwise threatening the very nature of legal practice in Australia, instead the Part IVA regime has been judiciously and appropriately engaged in order to hold wrongdoers to account and compensate those who have suffered real loss or damage at their hands.

Over the course of more than a quarter of a century the regime matured and ripened into a mainstream feature of the Australian legal system, and in that time we have seen the development and evolution of class actions practice and procedure as new issues emerged

[1] V Morabito, "The First Twenty-Five Years of Class Actions in Australia" *Fifth Report: An Empirical Study of Australia"s Class Action Regimes* (2017) (**Morabito Fifth Report**), 35.
[2] Quoted in F Hawke, "Class Actions: The Negative View" (1998) 6 *Torts Law Journal* 1, 7.

and were addressed by the Court and by litigants. It is, however, an opportune time to take stock of the current regime and review the empirical evidence as to the way that it is functioning, and consider whether the current state of class actions practice warrants legislative or other reform so that the operation of the regime might be improved for its intended beneficiaries.

The ALRC's *Class Action Proceedings and Third-Party Litigation Funding*, Discussion Paper No 85 (2018) (**Discussion Paper**) canvasses a range of reform options across a number of different areas of class actions practice. In our view any reform proposals should be guided by two overarching imperatives, namely:

1. improvement of outcomes for and returns to class members; and

2. the removal of obstacles that continue to stand in the way of meritorious claims.

Few would have foreseen the advent of third party litigation funding in class actions, commencing in the early to mid 2000s and becoming increasingly common over the last decade, particularly in shareholder and securities class actions.[3] There is little doubt that litigation funding – conventionally involving indemnification of the representative plaintiff for adverse costs and provision of cash flow for payment of the plaintiff's lawyer – has made it possible for meritorious claims to be pursued and successfully concluded for the benefit of many thousands of investors. However, the prevalence of litigation funding and growth in the number of funders who are active in the Australian market now justifies the development of a customised licensing regime in order to ensure consumer protection.

Despite the benefits of litigation funding, it has become apparent that not all types of class action claims are attractive to litigation funders and that there is a gap left by the investment policies of funders and the reluctance of individual plaintiffs to assume substantial adverse costs risks in cases involving conditional fee arrangements. In particular, it is clear that many comparatively small potential class actions are falling through the cracks. To the extent that smaller class actions have been pursued with support from litigation funders – for example the modestly sized shareholder claims discussed in Section 5 below – it is clear that outcomes for class members would have been significantly better if a single contingency fee, rather than a litigation funding commission plus legal costs, were deducted from the resolution sum.

Lifting the current ban on contingency fees would address both of these issues – modestly sized claims could be pursued on the basis of economically viable funding arrangements and returns to class members would be improved. To the extent that contingency fee arrangements might be applied to the types of cases that are already well serviced by third party funders, there is an opportunity for competition to place downward pressure on funders' commission rates which, again, is in the interests of class members.

While the overall incidence of overlapping or competing class actions remains relatively low,[4] a small number of recent high profile cases have called into question the need for reform where more than one class action is instituted in respect of the same alleged wrongdoing. Again, the

[3] Morabito Fifth Report, 13-14, 33-34.

[4] Morabito Fifth Report, 40: Professor Morabito"s empirical research findings are that there was a total of 34 instances of overlapping or competing claims as at 30 June 2017; this compares to the total of 513 class actions since 1992.

interests of class members should be the guiding principle, taking into account the totality of class members' interests including their own preferences and the entirety of the equation which dictates returns following a successful class action.

While we support the need for reform in this aspect of class actions practice, in our view any reform proposals should not be inflexible and it should not be assumed that all instances of overlapping or competing claims can and should be resolved in the same way. Options for reform should not be singly informed by a relatively infrequent phenomenon that occurs predominantly in one species of class action, namely shareholder claims that are, in the main, supported by litigation funders. One of the best characteristics of the existing Part IVA regime has been its flexibility in being able to adapt to novel issues of practice and procedure and to tailor solutions that are appropriate to the circumstances of individual cases.

Avoidance of an overly rigid approach is a theme which pervades a number of areas in our submission, and in our view it is also important to ensure that reforms are evidence based responses to issues of policy, and not driven by unproven claims or assertions regarding perceived problems.

We summarise our submission in response to the issues and proposals in the Discussion Paper as follows:

Chapter 1	Introduction to the Inquiry	There is no cogent evidence of any need for a review which may disturb the operation of the existing, well-functioning continuous disclosure regime Criticisms of the current regime are illusory or misconceived
Chapter 3	Regulating litigation funders	We support the introduction of a bespoke licensing regime for litigation funders
Chapter 4	Conflicts of Interest	We support all of the ALRC's proposals except mandating that the first notice to class members must include detailed information regarding conflicts of interest – rather, the Court should retain flexibility to adapt the need for and nature of information to the circumstances of individual cases
Chapter 5	Commission Rates and Legal Fees	We support the proposal that class action lawyers be permitted to receive contingency fees and we support other ancillary proposals that are designed to provide safeguards in relation to contingency fee arrangements, including the Court having the power to vary or set the rate of a contingency fee We do not support the introduction of a mandatory sliding scale or a blanket ban on contingency fees in certain types of class actions – again, the Court should retain a discretion to craft appropriate orders in individual cases

Chapter 6	Competing Class Actions	There is a need to introduce new procedural mechanisms to address the orderly coordination of competing or overlapping class actions, however we do not support the ALRC's proposal, which is overbroad The Court should retain more flexibility in dealing with competing or overlapping claims, rather than enshrining a default position that may be inapt for all types of class actions and all circumstances in which there are competing or overlapping actions The interests and preferences of class members, in their totality, should be paramount and an excessive focus on "price" should be eschewed
Chapter 7	Settlement Approval and Distribution	Limited to lawyers with experience in conducting settlement administrations, a panel should be established in order to enable a tender process in appropriate cases A lawyer proposing to carry out a settlement administration could also be directed to investigate the efficiency and cost benefits of using non-legal service providers for discrete aspects of an administration
Chapter 8	Regulatory Redress	We support the introduction of a federal redress scheme as an alternative mechanism for victims of corporate misconduct to receive compensation, however victims should retain their rights to pursue conventional litigation (including a class action) if they consider that it is in their interests to do so

In the remainder of this submission we set out in detail our response to the ALRC's specific proposals and questions.

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1. SHAREHOLDER CLASS ACTIONS

> **Proposal 1-1** The Australian Government should commission a review of the legal and economic impact of the continuous disclosure obligations of entities listed on public stock exchanges and those relating to misleading and deceptive conduct contained in the *Corporations Act 2001* (Cth) and the *Australian Securities and Investments Commission Act 2001* (Cth) with regards to:
>
> - the propensity for corporate entities to be the target of funded shareholder class actions in Australia;
> - the value of the investments of shareholders of the corporate entity at the time when that entity is the target of the class action; and
> - the availability and cost of directors and officers liability cover within the Australian market.

1.1 The ALRC seeks comment on a proposal that the Australian Government should commission a review of the legal and economic impact of statutory continuous disclosure obligations and prohibitions on engaging in misleading or deceptive conduct in connection with financial markets, with reference to three specific issues that are said to arise from the operation of the legal regime.

1.2 As a preliminary point, we consider that a review framed in those terms may have limited utility. Regulatory measures often operate to effect a positive outcome by imposing a cost on those who engage in misconduct. Considering the cost of a regulatory measure, with reference to perceived burdens imposed by it, will inevitably result in a distorted view of its effectiveness unless consideration is also given to the benefit that it provides in addressing misconduct.

1.3 Having regard to the three specific issues noted by the ALRC as creating cause for concern, we do not believe that they provide a sound basis for revisiting the existing legislative provisions and listing rules which regulate market misconduct.

1.4 The creation of private rights for aggrieved shareholders, and the consequent positive effect on the integrity of financial markets, was acknowledged as an important impetus for establishing the Federal class action regime. The government of the day described the new regime as affording enhanced access to justice for shareholders and providing great aid to the Australian Securities Commission (as it then was).[5] The important role played by shareholder class actions in addressing corporate wrongdoing has since been recognised by the Court and regulators.[6]

[5] Commonwealth, *Parliamentary Debates*, Senate, 13 November 1991, 3026, Michael Tate, Minister for Justice and Consumer Affairs.

[6] *Kirby v Centro Properties Ltd* (2008) 253 ALR 65, 67-68; A Boxsell, "Regulators Praise Private Court Actions", *The Australian Financial Review* (Sydney), 5 April 2012, 59; S Drummond, "ASIC Chief Sets Sights on Financial Advisors", *The Age* (Melbourne), 25 June 2014, 24.

The supposed propensity for corporate entities to be the target of funded shareholder class actions in Australia

1.5 There is no objective evidence to support an assumption that there is an excessive propensity for corporate entities to be the "target" of funded shareholder class actions in Australia.

1.6 In its 2014 report on Access to Justice, the Productivity Commission's analysis demonstrated that companies listed on exchanges in the United States are fifteen times more likely than companies listed in Australia to face shareholder class actions.[7]

1.7 Recent data from Canada shows that the litigation risk for listed companies is approximately 20% higher there than in Australia. In the period from 2015 to 2017, the annual litigation risk for companies listed on the Toronto Stock Exchange was approximately 0.3%.[8] Over the five years to May 2017, a total of 27 Australian companies were named as defendants in shareholder class actions.[9] Given that the number of ASX-listed entities remained at around 2,200 throughout that period,[10] this represents an annual litigation risk of approximately 0.25%. It should be noted that this data covers a reporting period over which the frequency of filings in Canada was lower than average, and the frequency of filings in Australia was higher than average.[11] Calculated over the longer term the litigation risk in Canada is approximately 0.5%, twice the current level in Australia.[12]

1.8 The ALRC suggests there may be growing evidence that unusual features of Australia's statutory continuous disclosure laws when compared to other common law jurisdictions have created unintended adverse consequences.[13] In our view the evidence shows that Australia's pairing of an enforceable statutory disclosure regime with a viable means of collective redress has created a more stable and attractive market for investors than would otherwise be the case, and in fact operates to *reduce* litigation risk for companies which do not engage in wrongdoing.

1.9 This is evident when one contrasts the statutory regimes and litigation environment in the United States, Canada and Australia. By their combined operation, section 674 of the *Corporations Act 2001* (Cth) and the ASX Listing Rules impose statutory continuous disclosure obligations on Australian-listed companies with liability set at what is effectively a negligence standard.[14]

[7] Productivity Commission, *Access to Justice Arrangements* (Inquiry Report No 72, September 2014) (**Productivity Commission, 2014**), 618.
[8] B Heys and R Patton, "Trends in Canadian Securities Litigation", NERA Economic Consulting, 20 February 2018, 3.
[9] Morabito Fifth Report, 31.
[10] ASX Limited, *Annual Report 2017* (2017), 77.
[11] Heys and Patton, above n 8, 3; Morabito Fifth Report, 31.
[12] Heys and Patton, above n 8, 3.
[13] Discussion Paper, [1.73].
[14] See ASX Listing Rule 3.1 and the definition of "aware" in Chapter 19 of the ASX Listing Rules, which relevantly provides that an entity becomes aware of information if an officer of the entity "ought reasonably to have come into possession of the information in the course of the performance of their duties". Importantly this means that liability cannot be avoided on the basis of lack of subjective knowledge on the part of company officers if the entity's oversight processes are objectively inadequate.

1.10 In the United States, the liability threshold is set at its highest: there is no general continuous disclosure obligation which sounds in damages. Liability typically attaches to positive misleading statements in periodic reporting, or failure to subsequently qualify such statements after changing circumstances render them misleading.[15] The level of fault that must be established is also the highest of all three jurisdictions. The aggrieved party must lead cogent and compelling evidence that an alleged violation was attended by a subjective fraudulent intent.[16]

1.11 The practical effect of these features of the American regime are instructive. Research shows that companies listed in the United States may tend to avoid making voluntary disclosures to the market, presenting a 'small target', in order to avoid litigation risk.[17] Such a course of action would be of no avail in Australia due to the existing statutory regime under which failure to disclose material information may itself attract civil liability. This is an important structural feature of the Australian regime which creates better incentives in respect of corporate disclosure.

1.12 There is thus a very high bar to establishing liability in United States securities fraud cases (both in terms of the lack of a right of recovery in respect of continuous disclosure breaches and in the requirement to establish a subjective intention to defraud), yet at the same time shareholder litigation is significantly more prevalent. This is no coincidence. The effect of imposing liability in respect of periodic reporting, without imposing a right of action where entities fail to meet their obligations to continuously disclose material information, is to increase the number of 'earnings surprises' which take place when periodic reports are released.[18] This follows from the fact that, in the absence of an enforceable obligation to disclose new information, it is more likely that such information will be released in periodic reporting, leaving the market to trade in an under-informed state prior to the release of the report.

1.13 The requirement to prove subjective intent to defraud cannot realistically exert any significant countervailing effect on the prevalence of litigation. The identity of the individuals involved in a contravention and their subjective knowledge of wrongdoing are unlikely to be definitively known to those outside an organisation before a claim has been filed, and often will not be clear until proceedings are significantly advanced. In practical terms, what one might expect is that proceedings will be issued where the circumstances of the revelation are such that an outsider would expect organisational management to have known about the information before it was disclosed to the market. There is therefore likely to be little, if any, reduction in the prevalence of litigation by imposing a subjective fault element, since proceedings remain likely to be commenced where an objective standard suggests that a violation may have occurred.

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[15] "Secondary market" securities class actions in the United States are typically brought under 17 CFR 240.10b-5, which relevantly makes it unlawful to "make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading" or to engage in fraud or deceit. Other provisions may apply in the case of statements made in initial or direct offerings.

[16] *Tellabs Inv v Makor Issues & Rights Ltd* (2007) 127 S. Ct. 2499 at 2509-2510.

[17] J Rogers and A Van Buskirk, "Shareholder Litigation and Changes in Disclosure Behaviour" (2009) 47 *Journal of Accounting and Economics* 136, 154.

[18] S Brown and C Shekhar, *Continuous Disclosure in Australia and the United States: A Comparative Analysis,* August 2016, 23-26.

1.14 In some cases evidence may emerge as litigation progresses which supports a finding of subjective knowledge of wrongdoing on the part of officers of the entity. In others, the necessary subjective element may never be established. Among the latter category will be proceedings brought against entities which, either by accident or design, avoid liability by having compartmentalised wrongdoing so that direct, subjective knowledge is limited to lower levels of the organisation. Such a strategy may prove to be an effective and sustainable method for entities to avoid liability in respect of what is effectively negligent conduct on the part of management, resulting in a lower deterrent effect from litigation and more scope for market-distorting conduct to go unpunished.

1.15 The United States securities regulatory framework, characterised as it is by the lack of private enforcement rights in respect of continuous disclosure and exemption from liability for breaches involving negligent rather than intentional wrongdoing, thus supports a regulatory environment in which shareholder litigation is far more common than in either Australia or Canada.

1.16 In Canada, continuous disclosure has statutory backing. Liability can be established on what is effectively a negligence standard, although the quantum of damages may be capped with reference to the market capitalisation of the listed entity.[19] Shareholders must also obtain the leave of the Court before commencing proceedings in respect of on-market purchases.[20] Common law causes of action which are not so limited operate alongside the statutory regime, although in common law claims direct reliance on a misrepresentation must be shown.[21] The Canadian position thus falls between Australia and United States, with some statutory backing for continuous disclosure obligations but significant scope for entities to limit or avoid liability for negligent non-disclosure. As would therefore be expected, the litigation risk for listed entities also falls between the relatively low risk face by Australian-listed companies and the relatively high risk faced by companies in the United States.

1.17 What the evidence establishes is that markets are more informed, more stable and litigation risk lower in a market characterised by continuous disclosure obligations with strong statutory backing in the form of private rights of action, and where entities cannot avoid liability for what are effectively negligent breaches of those obligations.

The prevalence of market misconduct

1.18 As a matter of logic, the suggestion that a cause of action which has regularly been relied upon successfully to obtain recoveries for aggrieved shareholders should, for that very reason, be subject to review imports an assumption that the issued proceedings are not an appropriate response to corporate misconduct. Such an assumption is unsupportable, particularly in the absence of comprehensive data on the frequency with which contravening conduct occurs.

1.19 To the extent that there is any evidence regarding the prevalence of corporate misconduct, we note that on the rare occasion that there are opportunities for

[19] See, for example, *Securities Act,* R.S.O. 1990, c S.5, ss 138.3(4), 138.7.
[20] *Securities Act,* R.S.O. 1990, c S.5, s 138.8.
[21] *Theratechnologies Inc v 121851 Canada Inc* [2015] 2 S.C.R. 106, 121.

concealed misconduct to be brought to light, as has occurred in the course of the ongoing Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, the picture that emerges is not one of a market weighed down by the unnecessary burden of rigorous compliance with continuous disclosure obligations. The Royal Commission has unearthed evidence of systemic misconduct at some of the largest listed entities in Australia, including instances of providing false and misleading information to corporate regulators.

1.20 In light of the prevalence of serious misconduct which has been and continues to be revealed at the Royal Commission, it would be inopportune to propose a review focused on whether the government should relax the existing obligations on public companies to keep the market informed. This is particularly so when the proposed review is framed only in terms of the legal and economic impact of continuous disclosure, and is not directed towards analysis of the extent to which market misconduct takes place or the benefits of the continuous disclosure regime including the deterrent effect of having a robust continuous disclosure regime.

The value of the investments of shareholders

1.21 Unsurprisingly, research shows that when information is revealed which ultimately leads to a shareholder class action, by far the most significant price impact occurs when the revelations themselves come to light. There is evidence from overseas jurisdictions that a much smaller price impact may also occur when proceedings are issued.[22] These findings support the view that entities which fail to meet their disclosure obligations run the risk of significant adverse market reaction, but the real threat to the value of their shareholders' investments comes from the conduct itself, rather than any ensuing litigation. The resolution of a shareholder class action does not have a significant impact the entity's share price.[23] In effect the prospect of litigation is priced in at a much earlier stage, as just one of the consequences of misconduct. Shareholder class actions could not have any deterrent effect if it were otherwise.

1.22 What is missing from the arguments advanced by proponents of the so-called "circularity" critique of shareholder class actions is a nuanced understanding of the diverse goals, backgrounds and investing behaviour of participants in shareholder class actions. In our experience, after revelations of a failure to make timely disclosure, individual shareholders (for example, relatively small holders with shares held in self-managed superannuation funds) are often disappointed and frustrated with the firm's failures, and in many cases will sell out of the company to avoid further losses. In those circumstances there is no circularity: individuals recoup some of the losses they have suffered as a result of the firm's misconduct. Obtaining compensation is typically a priority for such shareholders.

1.23 Institutional investors with much larger holdings may be less likely to sell out of a company following a corrective disclosure, and in some cases may even see a buying opportunity following a corrective disclosure. However as long-term participants in the

[22] P Lieser and S Kolaric, "Securities class action litigation, defendant stock price revaluation, and industry spillover effects" (Paper presented at the European Financial Management Symposium, Basel, 29 June 2016) 34.
[23] Ibid 35.

market, their aims and concerns are also different. In our experience the role of shareholder class actions in promoting market integrity is as important for many institutional participants as the compensation they may receive in any one proceeding.[24]

1.24 In fact, recent research shows that shareholder class actions are not a zero-sum game for investors in defendant companies. On the contrary, over the medium term they operate to increase the value of the investments of shareholders who choose to retain their stake. Empirical research into the impact of shareholder class actions on financial performance of the target entities draws two important conclusions. *First*, while firms which are targeted in shareholder litigation show a decline in performance around the time that proceedings are issued, that decline forms part of a downward trend that begins well before the prospect of litigation is raised and, indeed, before the corrective disclosure comes to light.[25] Thus the relationship between shareholder litigation and worsened firm performance is better explained as an instance of correlation rather than causation. Both are consequences of sub-optimal conduct by the firm's officers.

1.25 *Secondly*, following a shareholder class action, research shows that the longer term effect on company performance is positive, with companies treating litigation as a catalyst to improve their operations.[26] These long term trends have been masked in some previous studies which have only followed firm performance over a truncated period.[27] In the medium to long term, the putative problem of circularity is actually revealed to be a win-win scenario for shareholders who participate in litigation and retain a medium or long term stake in the defendant company. Such shareholders will receive compensation for the loss they have suffered and can also expect better performance on their investments in the future.

1.26 As an illustration of this phenomenon, we note the numerous instances of corrective disclosure that ultimately culminated in or led to changes in senior management, as occurred with Bellamy's Australia Ltd, which was recently the subject of a shareholder class action.

1.27 In addition, it is not uncommon for a company's auditors or advisors to be joined as co-respondents in shareholder class actions. In such cases the question of circularity does not arise, since the payment is effectively restitution from parties external to the company who caused loss to shareholders by enabling or participating in the impugned conduct.

1.28 For the foregoing reasons, we consider that a careful analysis refutes the suggestion that shareholder class actions have a negative impact on the value of the investments of shareholders. Instead they can be a means of restoring value by generating positive change in the defendant's conduct, in addition to their broader role in ensuing market integrity.

[24] See, for example, the comments of Michael Guilday of CBUS reported in P Liddy, "Australia has a way to go to punish corporate wrongdoing" *Investor Strategy News*, 4 December 2016.
[25] M McCarten and I Diaz-Rainey, "Securities class actions and operating performance" (2017) 43(1) *Managerial Finance* 44, 56.
[26] Ibid 51.
[27] Ibid 56.

The availability and cost of directors and officers liability cover within the Australian market

1.29 In our view concerns regarding the cost of directors' and officers' (**D&O**) insurance are misconceived. To the extent that D&O insurance is said to be under-priced, the most obvious solution is for insurers to review their pricing. Reinsurance giant Gen Re recently commented that insurers and reinsurers who offer D&O insurance products must price their coverage to take into account the fact that class actions are an established feature of the Australian legal system.[28]

1.30 When concerns are raised about the cost of premiums for D&O coverage, the economic impact of the misconduct that prompts shareholder class actions is largely ignored. The suggestion that coverage should be priced to prevent any significant economic impact on those who engaged in wrongdoing amounts to an argument that the costs of misconduct should be almost entirely externalised and borne either by the market or by insurers. If the level of wrongdoing and consequent market distortion is reduced, assuming sound actuarial practices on the part of insurers, the cost of premiums will decline commensurately.

1.31 On that point, we believe that the providers of D&O coverage have an important role to play in ensuring sound corporate governance. In a sophisticated market for D&O insurance such as the United States, providers undertake a detailed risk analysis of prospective insureds, and price their coverage accordingly. This process may involve gathering public information and engaging in private consultations with senior managers to develop a risk profile.[29] One of the key integers to that risk analysis is the insurer's assessment of the strength of the insured's corporate governance.[30] Importantly, qualitative factors such as flaws in corporate culture and character, which do not always form a reliable basis for establishing legal liability (at least when taken on a holistic basis), are relevant to the pricing of risk.[31] The results of this analysis then inform the availability and pricing of any D&O coverage that may be offered. The effect is that premium prices vary inversely with governance quality.[32] If some Australian providers of D&O insurance are not currently adopting the same approach, it would be open to them to do so in order to ensure that they are pricing risk appropriately.

1.32 We support the preventative role that responsible providers of D&O coverage can play in identifying the kind of corporate governance failures that create litigation risk prior to that risk crystallising, putting firms on notice of potential governance failures, and (by pricing premiums accordingly) establishing a direct economic incentive for companies to address governance failures *before* they sound in damages. We again note that the purchasers of D&O coverage which may be subject to shareholder class actions comprise a relatively small number of sophisticated entities, with significant

[28] E Fernandez, "Class Actions in Australia – A Quarter Century Later" (June 2018) *Casualty Matters International*, 3-4.
[29] T Baker and S Griffith, "Predicting Corporate Governance Risk: Evidence from the Directors' and Officers' Liability Insurance Market" 74(2) *The University of Chicago Law Review* 487, 511.
[30] Ibid 516.
[31] Ibid 523-525.
[32] Ibid 533.

resources at their disposal, and accordingly they are capable of negotiating the terms of such policies and understanding the impact of their own practices on premiums.

1.33 For those reasons we submit that the ALRC should place little weight on unattributed anecdotal reports from some listed entities to the effect that they have considered listing in another jurisdiction due to the cost of D&O premiums.[33] It is perhaps unsurprising that some entities would prefer to operate in a listing environment in which the consequences of market misconduct are borne by others. To the extent that premiums have been increasing, this is partly attributable to a correction in a market which has historically been under-priced due to competition from new entrants.[34] And an alternative solution for listed entities which take their corporate responsibilities seriously, a solution which would not have the effect of permitting wrongdoing while denying compensation to their shareholders, would be to adopt more rigorous governance practices and thereby reduce their litigation risk.

1.34 Another possibility which should be considered is mandating appropriate levels of insurance for companies listed on the ASX with a graduated level of cover increasing broadly in line with market capitalisation (perhaps on the basis of whether a company is in the ASX 200). This would provide protections to shareholders who are victims of failures of disclosure at the same time as providing a level of certainty to insurers regarding the D&O market which in turn will help place downward pressure on premiums.

Conclusion

1.35 In light of the above, it is our submission that the relatively low litigation risk for Australian-listed companies coupled with a strong track record of successful Australian shareholder class actions is evidence of a regime which is capable of responding well, and in a targeted manner, to the vice which it was intended to cure – a vice which regrettably remains persistent. In other words there is no evidence of any pattern of unmeritorious shareholder class actions or systemic misuse of the Part IVA regime in order to achieve justice for aggrieved shareholders.

1.36 There is no sound evidentiary basis to conduct a review of the existing, carefully balanced and well-designed Australian continuous disclosure regime.

[33] Discussion Paper, [1.74].

[34] For example, see Aon Australia, "Directors & Officers Insurance Market Update – Q3 2017", available at http://www.aon.com.au/australia/insights/insurance-market-updates/2017/directors-and-officers-insurance-market-updates.jsp.

2. INCIDENCE

2.1 We note that this chapter of the Discussion Paper does not pose any questions or offer any proposals for reform.

2.2 Contrary to some of the inaccurate and alarmist claims that are made in the press and in other contexts in relation to the incidence of class actions and in particular shareholder class actions, we also endorse the ALRC's observations that:

(a) class actions constitute a small proportion of the claims that were filed in the Federal Court;

(b) there has been an increase in the number of shareholder class actions filed in the second half of the period since Part IVA was introduced, although as was discussed above in response to Proposal 1-1, the overall incidence of shareholder class actions remains extremely low in comparison to the number of listed entities.

3. REGULATING LITIGATION FUNDERS

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

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

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

3.1 The emergence of third party litigation funding has undoubtedly improved access to justice for many thousands of individual and corporate claimants in a variety of legal disputes including class actions, and in our experience (as is also acknowledged by the ALRC[35]) there is limited evidence of the failure of litigation funders or, we would add, misconduct by litigation funders.

3.2 Nevertheless, in the interests of consumer protection and consistently with the views of both the Productivity Commission in its 2014 report[36] and the Victorian Law Reform Commission (**VLRC**) in its recent report,[37] we agree with the ALRC's proposal for the establishment of a licensing regime for litigation funders..

3.3 As did the Productivity Commission in its 2014 report, the ALRC acknowledges the risks that a licensing regime may create barriers to entry and dampen competition in the funding market.[38] However, in our view Proposals 3-1 and 3-2 are unlikely to create unreasonable barriers to entry and we therefore broadly support these proposals.

[35] Discussion Paper, [3.25].
[36] Productivity Commission, 2014, 632.
[37] Victorian Law Reform Commission, *Access to Justice – Litigation Funding and Group Proceedings: Report* (2018) (**VLRC, 2018**), [2.21]-[2.33].
[38] Discussion Paper, [3.22].

3.4 We also agree that:

(a) it is preferable for a bespoke licensing regime to be established for litigation funders, rather than seeking to adapt the existing AFSL regime to litigation funders;

(b) it is appropriate that ASIC be the regulator of the litigation funding licensing regime, rather than legal profession regulators. One of the reasons for this is that ASIC is a national body with existing capabilities to carry out this type of regulatory oversight, whereas there are different legal profession regulators in each of the states and territories.

3.5 In relation to the specific features of Proposal 3.2, we make a number of minor comments:

(a) first bullet point – while it may be implicit, in any event we suggest that the proposed license should reflect a requirement to "do all things *reasonably* necessary" to ensure that their services are provided efficiently and honestly;

(b) third bullet point – it is our view that the *Corporate Amendment Regulation 2012 (No 6)* (Cth) and Regulatory Guide 248 are adequate in terms of the arrangements that are required in order to manage conflicts of interest and we consider that the substance of these requirements would also be adequate for the purpose of any new licensing regime;

(c) fifth bullet point – risk management systems should be adequate and as reasonably required having regard to the size and scope of the particular litigation funder's operations – it would pose unreasonable burdens if a "one size fits all approach" is taken;

(d) seventh bullet point – considering the lack of evidence of widespread or systemic misconduct by litigation funders we query the utility and administrative burden associated with annual audits, and whether the regulator should rather be empowered to require an audit on an as needs basis.

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

3.6 We support the introduction of minimum requirements for character and qualifications of responsible officers who seek to obtain a litigation funding licence.

3.7 We agree that the character requirements that are currently imposed on AFSL holders would be appropriate for applicants for a litigation funding licence. In particular it would be appropriate for the regulator of the litigation funding licensing regime to consider any previous convictions for fraud, whether the applicant's litigation funding licence was previously suspended or cancelled, and whether the applicant (or any of its directors and officers) has previously been disqualified or banned from serving as a director.

3.8 Recognising that corporate applicants for a litigation funding licence would commonly include directors and officers with relevant professional experience in legal, accounting or financial services industries, it might also be relevant to consider whether the applicant, or any directors and officers of the applicant:

(a) have previously been the subject of disciplinary action by a legal profession or accounting profession regulator; and/or

(b) previously held an AFSL and if so whether it was ever cancelled or suspended.

3.9 In relation to qualifications, we agree with the ALRC's general comments to the effect that the skills and knowledge required by litigation funders include both financial skills as well as legal skills.[39] We also agree that the skills and knowledge requirements could be assessed in a manner that is analogous to the process for demonstrating skills and knowledge by AFS licensees under Regulatory Guide 105.

3.10 We also agree with the ALRC's view[40] that it is not necessary for litigation funders to be regulated similarly to lawyers.

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

3.11 We maintain[41] our view that the most efficacious and straightforward way to ensure that funders can meet their financial obligations to pay adverse costs is by means of an order for security for costs.

3.12 However we acknowledge the ALRC's view[42] that an order for security for costs does not negate a broader need for a capital adequacy requirement, particularly to the extent that such a requirement forms part of the licensing regime proposed in Proposals 3-1 and 3-2 and contemplated in Question 3-1. We also acknowledge, as is noted by the ALRC,[43] that an order for security for costs does not provide protection for a representative plaintiff from unpaid legal fees of its own solicitors, although we also make the observations that:

[39] Discussion Paper, [3.39].
[40] Discussion Paper, [3.42].
[41] For example, see Maurice Blackburn's submission to the VLRC, [12.1]-[12.5], referred to in the ALRC's Discussion Paper, [3.44].
[42] Discussion Paper, [3.49].
[43] Discussion Paper, [3.49].

(a) we are not aware of any instances where a litigation funder suffered financial failure and the representative plaintiff's solicitors subsequently sought to enforce an obligation by the plaintiff personally to pay legal fees;

(b) we are not aware of any instance where the financial failure of a funder in fact compromised the defendant's position in relation to costs in the event that the plaintiff's case failed.[44]

3.13 In *Clasul Pty Ltd v Commonwealth of Australia* (proceeding NSD 368 of 2013) in which we acted as the plaintiff's lawyers, the funder did suffer financial failure, however the applicant was not put in a position where it became obliged to pay legal costs,[45] and the defendant's interests had been protected by further orders requiring security for costs by means of an after the event insurance policy.[46]

3.14 If the ALRC recommends the introduction of capital adequacy requirements as part of a licensing regime for litigation funders:

(a) we support the adoption of AFSL requirements as discussed by the ALRC, which would require funders to provision approximately 5.5% of their liabilities as a buffer;[47]

(b) as discussed by the ALRC,[48] an exemption should apply for litigation funders who are based overseas if they meet comparable requirements in their home jurisdiction.

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

3.15 In our view it is appropriate for litigation funders to be subject to the dispute resolution scheme of the Australian Financial Complaints Authority (when it is established).

3.16 However, the types of disputes that may be resolved by AFCA should be subject to any issues over which the Court has exercised supervision in respective matters.

3.17 Additionally, it is worth noting that in our experience disputes in relation to litigation funding agreements are rare. We are not aware of any disputes arising in the context of litigation funding agreements between funders and their funded clients in matters where Maurice Blackburn has acted, including in relation to the appropriate approach to settlement offers and proposals. In our experience, the common practice of litigation funders incorporating dispute resolution mechanisms as a part of their standard contractual funding terms has worked well (including terms requiring the

[44] Cf *Jeffery & Katauskas Pty Limited v SST Consulting Pty Ltd; Jeffery & Katauskas Pty Limited v Rickard Constructions Pty Limited* [2009] HCA 43, where the funder had not provided an indemnity regarding adverse costs.
[45] *Clasul Pty Ltd v Commonwealth of Australia* [2016] FCA 1119, [45(d)] and [51].
[46] See orders made on 19 May 2016 in proceeding NSD 368 of 2013 (*Clasul Pty Ltd v Commonwealth of Australia*).
[47] Discussion Paper, [3.54].
[48] Discussion Paper, [3.62].

funder and the funded client to refer any disputes as to potential settlement of claims for determination by senior counsel). Again, we are not aware of any instance in funded matters in which Maurice Blackburn was involved, in which such dispute resolution mechanisms have been activated.

4. CONFLICTS OF INTEREST

Proposal 4-1 If the licensing regime proposed by Proposal 3–1 is not adopted, third-party litigation funders operating in Australia should remain subject to the requirements of Australian Securities Investments Commission Regulatory Guide 248 and should be required to report annually to the regulator on their compliance with the requirement to implement adequate practices and procedures to manage conflicts of interest.

4.1 As was noted above, we support the introduction of a new bespoke licensing regime for litigation funders as proposed by Proposal 3-1.

4.2 If Proposal 3-1 is not adopted by the ALRC in its final recommendations, we support the ongoing application of Regulatory Guide 248.

4.3 However we also share the ALRC's scepticism[49] that additional reporting requirements may be ineffective in guarding against misconduct, particularly where it involves subtle and potentially undetectable behaviours and conduct. In addition, it is not apparent to us that there is a demonstrated need for annual reporting.

4.4 Despite these reservations, provided that the proposed annual reporting obligations do not impose an unreasonable administrative cost and burden, we would not oppose a new requirement that funders report annually to the regulator as to their compliance with requirements regarding the management of conflicts of interests.

Proposal 4-2 If the licensing regime proposed by Proposal 3–1 is not adopted, 'law firm financing' and 'portfolio funding' should be included in the definition of a 'litigation scheme' in the *Corporations Regulations 2001* (Cth).

4.5 We support Proposal 4-2, which would remove doubt about whether alternative funding models such as "portfolio funding" and "law firm financing" fall within the ambit of regulation 5C.11.01 of the *Corporations Regulations*, thereby exempting those funding models from the requirements regarding "managed investment schemes" in Part 5C of the *Corporations Act*.

4.6 There is no reason why those alternative funding models (but not the "conventional" funding model) should be subject to the legal requirements under the *Corporations Act* for "managed investment schemes", and in order to create certainty it is appropriate for the definition of a "litigation scheme" in the *Corporations Regulations* to be amended so as to capture these alternative litigation funding models.

[49] Discussion Paper, [4.37].

> **Proposal 4-3** The Law Council of Australia should oversee the development of specialist accreditation for solicitors in class action law and practice. Accreditation should require ongoing education in relation to identifying and managing actual or perceived conflicts of interests and duties in class action proceedings.

4.7 The development of *voluntary* specialist accreditation will not address the issue identified by the ALRC[50] in relation to the increasing number of law firms acting for plaintiffs in class actions and the possibility that some of those law firms or individual lawyers may have little or no experience as to the complexities in class actions practice and the potential for conflicts of interest.

4.8 Nevertheless, as a means of enabling prospective claimants to identify reputable practitioners with demonstrated knowledge and experience in class actions, we support the development of specialist class actions accreditation and we agree that this should be done with uniformity across all Australian jurisdictions.

4.9 It might also be beneficial for the specialist accreditation to include a requirement for ongoing education in relation to conflicts of interest. This could occur by means of continuing legal education on, for example, a triennial basis.

4.10 In the absence of accreditation, an alternative means of ensuring that class action lawyers are aware of issues regarding conflicts of interest is to require a declaration to the local Law Society, for example in the context of renewing practising certificates.

> **Proposal 4-4** The Australian Solicitors' Conduct Rules should be amended to prohibit solicitors and law firms from having financial and other interests in a third-party litigation funder that is funding the same matters in which the solicitor or law firm is acting.

4.11 In light of the ALRC's proposal to recommend the introduction of contingency fees in class actions, we do not oppose Proposal 4.4, though we are not convinced that prohibition of such interests is the appropriate policy response rather than appropriate disclosure of those interests.

[50] Discussion Paper, [4.53]-[4.54].

Proposal 4-5 The Australian Solicitors' Conduct Rules should be amended to require disclosure of third-party funding in any dispute resolution proceedings, including arbitral proceedings.

4.12 In our submission Proposal 4-5 should not be adopted because it may cause unintended and undesirable consequences (including potentially conferring an unfair advantage on the defendant). Implementing Proposal 4-5 would also remove the discretion of the court to make orders in appropriate circumstances.

4.13 Our primary concern in relation to Proposal 4-5 is that litigation funding agreements are used in a broad range of types of litigation, many of which do not presently require disclosure to the court, nor is disclosure sought. For instance, in common single party commercial litigation matters where litigation funding is used, there is presently no requirement to disclose to the court or the other party the existence of litigation funding, in the same way that there is no obligation to disclose the existence and nature of any policy of insurance that may respond to the claim.

4.14 We endorse the view expressed by the VLRC in its recent report, namely that disclosure of funding agreements is not necessary in every proceeding that involves a litigation funder.[51]

4.15 In addition, if a blanket rule were introduced so as to require disclosure of third-party funding in any dispute resolution proceedings, including arbitral proceedings, this would also potentially capture the broader types of litigation funding schemes such as "portfolio funding" and "law firm financing",[52] in circumstances where such information may be commercially sensitive and have little relevance to the conduct of the litigation.

Proposal 4-6 The Federal Court of Australia's Class Action Practice Note (GPN-CA) should be amended so that the first notices provided to potential class members by legal representatives are required to clearly describe the obligation of legal representatives and litigation funders to avoid and manage conflicts of interest, and to outline the details of any conflicts in that particular case.

4.16 Our reservations regarding Proposal 4-6 are that additional disclosures regarding conflicts of interest in the first notice to class members:

(a) may not be necessary or desirable in all cases; and

(b) might give rise to practical difficulties.

[51] VLRC, 2018, [2.166] to [2.167].
[52] Discussion Paper, [4.40]

4.17 Disclosure of potential conflicts of interest already occurs by means of information provided by litigation funders to prospective members in accordance with the requirements of Regulatory Guide 248. Proposal 3-2 (above) also contains a requirement for licensed funders to have adequate arrangements for managing conflicts of interest, and we assume that these arrangements would include procedures to provide class members with information about actual or potential conflicts of interest.

4.18 In a funded class action, additional disclosure regarding conflicts may therefore only be needed to the extent that the class includes unfunded class members because those class members will not have received the funder's disclosure statement.

4.19 In an unfunded class action there is no tripartite relationship involving a litigation funder, class member and lawyer and the scope for conflicts is therefore inherently reduced. The focus of Chapter 4 of the ALRC's Discussion Paper is on conflicts that might arise from the tripartite relationship that occurs in a funded class action: the types of situations in which conflicts might occur are predominantly the product of that tripartite relationship.[53]

4.20 In an unfunded action where there is no litigation funder, the ALRC describes the potential for conflicts where class members did not all suffer the same damage and may not be seeking the same remedy, and therefore the potential for conflicts in the duties owed by solicitors to different class members or categories of class members.[54] This is the only type of conflict that is described by the ALRC as potentially occurring in an unfunded action. To the extent that such a conflict exists in a class action, it may be unavoidable depending on the way that the class is defined, and it is unclear to us how the provision of detailed information will assist in managing these potential conflicts. Disclosure of these types of conflicts at an early stage of the proceeding will be arid, lacking in context and any real practical application, and may therefore be confusing or unnecessarily alarming for class members.

4.21 In addition, the requirement for approval of any settlement pursuant to section 33V of the *Federal Court of Australia Act* already provides a satisfactory safeguard in managing the potential for conflicting interests of different categories of class members. Lack of differentiation between different categories of class members, whose claims may carry differing prospects of success, may be a reason why a proposed settlement is not approved.[55]

4.22 Despite the best intentions of the drafters of notices to class members, in our experience these notices are commonly already long, containing complicated information covering a variety of topics. We are concerned that the inclusion of detailed information concerning conflicts of interest will in some cases only create to confusion among some class members. The first notices to class members should convey essential information regarding the class action and class members' rights

[53] Discussion Paper, [4.7]-[4.9]; see also VLRC, *Access to Justice – Litigation Funding and Group Proceedings: Consultation Paper* (July 2017), 44.
[54] Discussion Paper, [4.10].
[55] See for example *Peterson v Merck Sharp & Dohme (Australia) Pty Ltd (No 6)* [2013] FCA 447, [17]; *Peterson v Merck Sharp & Dohme (Australia) Pty Ltd (No 7)* [2015] FCA 123. See also *Australian Securities and Investments Commission v Richards* [2013] FCAFC 89.

without also being laden with a potentially lengthy and non-contextualised excursus regarding potential conflicts of interest.

4.23 Different methods are also used in order to disseminate the notice to class members, including direct mail and newspaper or other print media advertisements and increasingly also social media and other digital media. Depending on the method of distribution, the addition of more information to an already long and complicated notice may be undesirable and may add to costs; for example, in a printed newspaper advertisement.

4.24 In our view, rather than mandating a requirement for disclosure of conflicts in the first notice in all class actions, the preferable approach is for the Federal Court of Australia's Practice Note (GPN-CA) to retain flexibility as to the need for and nature of information that may be provided to class members in relation to actual or potential conflicts. In particular the practice note could be amended to require the Court to consider whether the first notices to class members ought to include information about conflicts of interest, having regard to:

(a) the funding arrangements that subsist in an individual case;

(b) the definition and composition of the class including any sub-groups or sub-categories of class members, and the types of claims that are made;

(c) the method by which the notice is to be given to class members and the timing of the notice.

4.25 Where it is considered that information regarding conflicts should be provided to class members, we would support the ALRC's suggestion[56] that information regarding actual or potential conflicts be included in a link, rather than incorporated into the body of the notice itself, or at least that this option should be available to the Court in the interests of avoiding unnecessarily lengthy notices that may cause confusion.

[56] Discussion Paper, [4.71].

5. COMMISSION RATES AND LEGAL FEES

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

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

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

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

5.1 Consistently with the policy momentum that is reflected in the VLRC's 2008 report,[57] the Productivity Commission's 2014 report and the VLRC's more recent March 2018 report, we support the proposed introduction of contingency fees as reflected in Proposals 5-1 and 5-2. These proposals will increase access to justice and improve outcomes for class members for a variety of reasons as discussed in greater detail below.

5.2 Arguments made by proponents of the current ban on contingency fees are either illogical or alarmist or they fail to take into account the matters that would safeguard against unmeritorious claims or the inappropriate management of conflicts of interest.

5.3 However, the legal profession is regulated by state and territory legislation – despite the ongoing impetus for nationally consistent legal profession regulations, presently there are practical obstacles to the attainment of uniform legislative change regarding contingency fees across all jurisdictions.

5.4 A pragmatic alternative or interim solution would therefore be to adopt and apply the VLRC's recent Recommendation 8,[58] which would involve the amendment of Part IVA of the *Federal Court of Australia Act* so as to create an express power for the Court

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[57] Victorian Law Reform Commission, *Civil justice review: report* (March 2008).

[58] VLRC, 2018, [3.66]-[3.98].

to make a common fund order for a "litigation services fee" or other similarly termed payment that is substantively and structurally the same as a contingency fee.

General observations – case selection and costs

5.5 Removal of the ban on contingency fees for class actions will fill a gap in legal services created by the reality of available funding options, thereby enabling meritorious claims to be prosecuted and increasing access to justice. Lifting the ban is also likely to promote competition in the funding market, putting downward pressure on the commission rates of litigation funders and in turn increasing returns to class members.

5.6 Since it became an established feature of class actions practice in the mid to late 2000s, third party litigation funding has improved access to justice by facilitating many meritorious claims, predominantly by shareholders and investors.[59] However in certain cases there is the potential for class members to receive better returns by means of contingency fees because the combined cost of a lawyer's fees and litigation funder's commission and charges would (unsurprisingly) be greater than an appropriately structured contingency fee arrangement.

5.7 The following table, an earlier version of which was also included in Maurice Blackburn's submission to the recent VLRC inquiry, shows the aggregate breakdown of the distribution of settlement sums from the sixteen funded class action cases Maurice Blackburn has settled since 2006 and compares the hypothetical distribution that would have occurred if lawyers had instead been permitted to charge a 25% contingency fee.[60]

Actual		**25% contingency fee**	
Settlement sums	$1,108m	Settlement sums	$1,108m
Funding Charges and Legal Costs	$446m	Contingency fee	$241m
Paid to Claimants	$662m	Paid to Claimants	$831m
% to Claimants	60%	% to Claimants	75%
Funder Profit	$283m	**Benefit to Claimants**	**$169m**

5.8 This analysis is broadly consistent with publicly available information in IMF Bentham's 2017 Annual Report.[61] IMF Bentham notes that claimants have had returned to them $1.3 billion of $2.1 billion recovered in cases funded by IMF Bentham; that is, approximately 62% of settlement value was distributed to claimants

[59] Morabito Fifth Report, 33-34: there were 116 funded class actions out of 513 in total (22%), 85 (73%) of which were shareholder and investor claims, 14 (12%) were consumer protection claims (mostly in relation to bank fees) and 17 (14%) were other types of claims.
[60] None of the cases involved claims for personal injury, so the amount payable on a 25% or 30% contingency fee does not need to be adjusted for third party repayments such as Medicare or private health insurance liens.
[61] IMF Bentham Ltd, *Annual Report 2017*, 2.

whilst approximately 38% was paid in legal fees and funding charges and commissions. Although the Maurice Blackburn and IMF Bentham data overlap, they are not coextensive.

5.9 These data suggest that a contingency fee which results in a return to class members of greater than 60% to 62% (equating to a contingency fee of 38% to 40%) will be a better outcome for class members than a funding scenario involving both a funding commission and legal costs.

5.10 However, the data in the above table includes several substantial settlements in shareholder and investor class actions,[62] and the difference in returns to class members is likely to be more stark when contingency fee arrangements are compared to smaller funded class actions where the combined amount of legal costs and funding commissions and charges are likely to constitute a higher proportion of the overall resolution sum.

5.11 The recent settlement approval in *Caason Investments Pty Ltd v Cao (No 2)* [2018] FCA 527 illustrates the suboptimal outcomes for class members that can occur where smaller shareholder claims are conducted with support from a litigation funder. The following table shows the distribution to class members, the litigation funder and lawyers pursuant to the approved settlement, and in a counterfactual scenario involving a contingency fee of 30%:

Actual settlement		**30% contingency fee**	
Settlement sum	$19.25m	Settlement sum	$19.25m
Litigation funder[63] (30%)	$5.78m	-	-
Legal costs (time based billing)	$7.56m	Legal costs (contingency fee)	$5.78m
Class members	$5.91m	Class members	$13.48m
% to Claimants	30.71%	% to Claimants	70.00%

5.12 Other examples of modestly sized class actions that proceeded with litigation are as follows:

(a) *Petersen Superannuation Fund Pty Ltd v Bank of Queensland Ltd* (proceeding NSD 362 of 2016), which recently settled for $12 million before sparking a quarrel between the litigation funder and lawyers as to their respective entitlements to be paid from the settlement sum;[64]

[62] These include the class actions against Centro ($200 million), Aristocrat Leisure ($144.8 million), QBE ($132.5 million), RiverCity ($121 million), National Australia Bank ($115 million) and Multiplex ($110 million) and Leighton ($69.45 million).
[63] A common fund order was made with a commission rate of 30%.
[64] See https://lawyerly.com.au/class-seeks-slash-quinn-emanuel-vannins-fees-millions/ (accessed on 17 July 2018).

(b) *Clarke v Sandhurst Trustees Ltd (No 2)* [2018] FCA 511, which settled for $16.5 million, with $4.9 million (30%) being paid to the lawyers and $5.055 million (31%) being paid to the funder, leaving 39% for payment to class members.

5.13 In the latter case, Lee J commented that:[65]

> This proceeding brings into focus a problem which bedevils representative proceedings of a certain type. The type to which I refer are those class actions which are commenced to recover what, in absolute terms, might be thought a considerable sum, but, when judged against the relative costs of litigation and the amount required to be paid to a funder in order to allow the proceeding to go forward, is not large.

5.14 The introduction of contingency fees would overcome the "structural difficulty"[66] associated with more modestly sized claims, enabling them to be conducted on the basis of arrangements for funding and payment of legal costs that allow better returns to class members. In each of the three cases mentioned above, outcomes for class members would have been significantly better if the cases had been pursued on a contingency fee basis, rather than on the basis of litigation funding coupled with conventional time based billing by the lawyers.

5.15 However, the reality is that many smaller claims simply do not attract funding because it is uneconomical and unviable for a litigation funder to invest. One of the reasons for this is a practical constraint that arises because litigation funders commonly require a return that is a specified multiple of funds invested in the case. Litigation funders often require at least a three times multiple before they will fund a case, though some overseas funders say that they require a multiple of ten times in a prospective action before they will approve funding; ie the prospective commission on the total amount claimed is ten times the proposed budget for legal fees. A three times multiple (let alone a ten times multiple) will often be impossible to achieve in a medium sized or smaller claim.

5.16 These constraints restrict the availability of funding. One of the major policy rationales for class actions is the promotion of access to justice through the aggregation of claims which it would otherwise be uneconomic or impractical to conduct on an individual basis. At present this policy objective is not realised in many potential claims that are too small to attract third party litigation funding, and where the prospective plaintiff is unwilling to assume the risk of a substantial adverse costs order in the context of conditional fee arrangements.

5.17 Our experience over the last decade or more since third party litigation funding became established is that we have investigated a significant number of potential class actions which were meritorious but which did not proceed because they did not or would not obtain third party litigation funding and because the cases were otherwise unable to be conducted on a conditional fee basis for one reason or another.

5.18 In other words, there is a range of worthy cases that simply do not proceed in the current environment. Contingency fees have the potential to close this gap and thereby improve access to justice. As the VLRC recently acknowledged in its report,

[65] *Clarke v Sandhurst Trustees Ltd (No 2)* [2018] FCA 511, [6].
[66] *Clarke v Sandhurst Trustees Ltd (No 2)* [2018] FCA 511, [26].

the "primary benefit of lifting the ban is that it would provide a funding option that enables pursuit of claims that are not suitable for litigation funding or charging on a 'no win, no fee' basis".[67]

5.19 In addition, litigation funding predominates in claims by shareholders and investors. Among the 513 class actions commenced in the 25 years since Part IVA was introduced in March 1992, there have been only 31 (6%) funded class actions in areas other than shareholder and investor claims,[68] and many of those 31 class actions were consumer protection claims arising from bank fees. In our view, in addition to the gap in funding options for lower value claims generally, there is also the potential for contingency fees to address an unmet need for funding in species of class action other than shareholder and investor claims, for example in cartel cases or consumer claims.

5.20 It is true that contingency fees will not direct funding to *all* areas of unmet legal need, as was noted by the VLRC in its recent report; for example, contingency fees might not facilitate claims in relation to certain types of consumer claims or housing matters that are less likely to result in large awards of compensation.[69] However there is still a sound policy justification for contingency fees if they meet *some* areas of unmet legal need as described above.

5.21 In addition to the potential for contingency fees to enable the prosecution of lower value claims that might otherwise (in the current environment) not proceed, the prospect of better returns to class members is also likely to foster competition for higher value claims that are already serviced by litigation funders. In other words, as was noted in the Discussion Paper, although contingency fees will not guarantee direct competition, it is likely to put downward pressure on commission rates.

5.22 As discussed above, there is little doubt that contingency fees will provide a cheaper option for class members in comparison with litigation funding, and in our view contingency fees will not only make it viable to conduct a range of cases that currently do not proceed but also create competition and reduce costs in types of cases that already attract third party litigation funders. Whether or not contingency fees provide a cheaper option for class members when compared with existing conditional fee arrangements will depend on the case in question, including the aggregate amount for which the claim is resolved and the permissible percentage of the contingency fee.

5.23 In its recent report the VLRC commented that it is "reasonable to expect contingency fees to be charged for some types of claim that previously would have been pursued, at less cost to the client, on a 'no win, no fee' basis".[70] We make two comments in this regard. *First*, when comparing potential outcomes in contingency fee arrangements with outcomes in conditional fee arrangements, it is important to bear in mind that the contingency fee is not simply a mechanism for calculating or determining the remuneration of lawyers for legal work done in prosecuting the claim. One of the critical features of the proposal for contingency fees is that the plaintiff

[67] VLRC, 2018, [3.36].
[68] Morabito Fifth Report, 33-34.
[69] VLRC, 2018, [3.16], citing the submission by Allens.
[70] VLRC, 2018, [3.36]; see also [3.27].

lawyer would also assume the risk of an adverse costs order and the lawyer advances any amount ordered for security for costs. This risk and this advance of funds have value for class action claimants and come at a cost which would be reflected in the contingency fee percentage, so in our submission the analysis is more nuanced than simply comparing percentage returns to class members in contingency fee and conditional fee scenarios. The law firm's assumption of the risk of an adverse costs order and the firm's outlay of potentially significant sums for security for costs provide a real benefit to class members insofar as these features of the proposal for contingency fees enable claims to be brought and prosecuted for the ultimate benefit of class members. This appears to be acknowledged by the ALRC insofar as Proposal 5-1 is framed on the basis that the contingency fee covers fees and disbursements as well as rewarding risk.[71]

5.24 *Secondly*, as will be discussed in more detail below in the context of Proposal 5-3, it is proposed that the introduction of contingency fees will be accompanied by an important safeguard insofar as the Court would have the power to reject, vary or set the percentage of any contingency fee. Presumably the exercise of that power will take into account not only the work done by the plaintiff lawyer and the fact that it was done on the basis that payment is conditional upon a successful outcome, but also the other risks assumed by the lawyer as well as the stage at which the class action is resolved.

General observations – ethical and other issues

5.25 Opponents of contingency fees commonly make a number of arguments that in our view are misguided.

5.26 *First*, it is said that contingency fees will motivate avaricious plaintiff lawyers to instigate a flood of unmeritorious claims, resulting in a "United States style" litigation culture. In the context of the Australian legal system and its "loser pays" principle, this argument should not be taken seriously.

5.27 Even in relation to conditional fee arrangements where the lawyer is only paid upon a successful outcome, it is difficult to imagine that a plaintiff lawyer would recklessly initiate a class action that carries a substantial risk of failure. A plaintiff lawyer's interest in careful merit investigation and case selection is even stronger in the context of contingency fee arrangements because the lawyer would not only be unremunerated for their work if the case fails, but also faces the prospect of paying an adverse costs order. It is fanciful to suggest that any competent lawyer would expose themselves to those risks on a frivolous basis when, as is the case in class actions, millions of dollars are at stake. And only the most foolish and irrational lawyer would assume those risks on the facile basis that "most cases settle", as has been argued by the US Chamber Institute for Legal Reform.[72]

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[71] See also the Discussion Paper, [5.35], where it is said that the proposal "adopts the principle that the contingency fee… reflects the risk of the litigation".

[72] See VLRC, 2018, [3.11].

5.28 Indeed, rather than resulting in a slew of unmeritorious cases, in our view contingency fees are more likely to result in plaintiff lawyers adopting a disciplined and rigorous approach to their merit investigations and case selection.

5.29 Alarmist submissions as to the likelihood of a torrent of unmeritorious claims were considered by the VLRC and rejected, which concluded that:[73]

> The Commission notes the concern that lifting the ban could encourage unmeritorious litigation, as has occurred in the United States, but considers the risk to be manageable. This is in part due to the operation of the costs-shifting rule in Australia, which, by requiring an unsuccessful party to pay adverse costs, acts as a disincentive to commencing unmeritorious litigation.

5.30 *Secondly*, opponents of contingency fees argue that contingency fees will compromise the independence of lawyers because they have a financial interest in the outcome of the case, which will create unacceptable conflicts of interest.

5.31 Contingency fees are relevantly the same as conditional fee arrangements insofar as lawyers in both scenarios have a direct financial interest in the outcome of the litigation. Lawyers acting on a conditional fee basis have demonstrated that they are able to act professionally and ethically and that they can acceptably manage any actual or perceived conflicts of interest in circumstances where their "investment" in the litigation may be worth many millions of dollars. This was acknowledged by the VLRC in its recent report, which cited a submission by the Victorian Legal Services Board to the effect that there have been very few complaints in relation to conditional fee arrangements, which were said to operate well and provide substantial access to justice.[74]

5.32 Arguably, contingency fees would result in a better alignment of the interests of the lawyer and client because the contingency fee arrangement will reward lawyers who are able to resolve litigation promptly and efficiently. By contrast, time based billing under a conditional fee arrangement does not provide this incentive.

5.33 Lest it be argued that lawyers would have an incentive to settle cases cheaply for the sake of certainty of being paid, the requirement for approval of class actions settlements under section 33V of the *Federal Court of Australia Act* also provides an important safeguard both in relation to the reasonableness of any resolution and in relation to the reasonableness and proportionality of the contingency fee.

5.34 Finally, lawyers in Canada and the UK are apparently able to comply with their ethical and professional obligations in the context of contingency fee agreements, however opponents of contingency fees in Australia seem to think that the ethics of Australian plaintiff lawyers will be irremediably challenged by the introduction of contingency fee arrangements. The VLRC was more optimistic about the capacity and ethics of Australian lawyers, concluding that it was "not persuaded that there would be a fundamental change to the lawyer/client relationship if the ban were lifted".[75] It is also

[73] VLRC, 2018, [3.12] and see also the reference to Canadian research, [3.13].
[74] VLRC, 2018, [3.49].
[75] VLRC, 2018, [3.50].

apposite to note that litigation funders, who are permitted to charge a percentage commission, owe no professional or ethical duties to the Court or to clients.

Specific comments on the ALRC's proposals

5.35 As we have also done in earlier contexts including the inquiries by the Productivity Commission in 2014 and the VLRC both in 2008 and in 2018, we advocate the introduction of contingency fees because we consider that these arrangements will improve access to justice as outlined above.

5.36 We also support the limitations proposed by the ALRC in Proposals 5-1 and 5-2.

5.37 *First*, it is appropriate that a class action funded through a contingency fee arrangement should not also be *directly* funded by a third party litigation funder.

5.38 On the other hand, in our submission any law reforms in relation to contingency fees should clearly permit two law firms to work together cooperatively in prosecuting a class action, for example after consolidation orders are made in relation to overlapping class actions or as a result of other collaborative arrangements. The two law firms should be able to be remunerated by sharing a contingency fee. Such a circumstance would not be appropriate in every case, however it should not be precluded by the limitations on contingency fee arrangements. It would also be subject to approval or leave of the Court, and would not be intended to increase the overall contingency fee percentage that is appropriate in any given case.

5.39 In addition, this limitation should not preclude a law firm (acting on a contingency fee basis) from assigning a portion of its contingency fee to a litigation funder in return for the funder assuming some of the risk that would otherwise be borne by the lawyer, for example in relation to adverse costs, or for providing cash flow to the plaintiff law firm in order to cover disbursements or for its conduct of the claim generally. In our submission this type of *indirect* funding by a third party litigation funder, which are akin to insurance or lending arrangements, should be permissible under any legal reforms relating to contingency fees.

5.40 *Secondly*, we agree that it is appropriate that a contingency fee should not be able to be recovered in addition to professional fees on a time-cost basis.

5.41 *Thirdly*, we agree that it is appropriate for solicitors charging a contingency fee to cover the cost of any disbursements as well as indemnify the representative applicant against an adverse costs order. This will, as the ALRC noted in its Discussion Paper and as we submitted above in relation to adverse costs, militate against unmeritorious claims. In addition, the requirement to indemnify the representative applicant for adverse costs will facilitate meritorious claims in the sense that some prospective applicants may be reluctant to assume a substantial adverse costs risk (as occurs in conditional fee cases), and the provision of an indemnity will overcome this obstacle.[76]

5.42 *Lastly*, we agree with the proposal (in Proposal 5-2) that contingency fees in class actions are only permitted with leave of the Court. The existing requirement for the

[76] See for example *Blairgowrie Trading Ltd v Allco Finance Group Ltd* [2017] FCA 330, [38].

Court to approve the settlement of a class action, including costs, would already have the effect of requiring the Court to sanction any contingency fee arrangements. We therefore assume that Proposal 5-2 was intended to provide that contingency fee arrangements would require leave at an early stage of the proceeding. If so, we would support such a measure in the interests of transparency and in order to provide certainty in relation to costs arrangements. However, we also note Proposal 5-3 (discussed below), which would empower the Court to reject, vary or set the percentage in any contingency fee arrangement, and we consider that it is more appropriate for this occur at the time of settlement approval or other resolution of a class action.

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

5.43 We disagree that the prohibition on contingency fees should remain in relation to some types of class actions. The ALRC's Discussion Paper refers specifically to two potential types of class actions.

5.44 *First*, the ALRC raises the possibility that contingency fees should not be permitted in personal injury matters. In the context of tort reforms in the early to mid 2000s, which introduced limitations on various heads of damages in many states and territories, there is an obvious rationale for the regulation of legal fees. Legal fees are regulated in order to protect the interests of plaintiffs and in particular to avoid a situation where an unacceptable proportion of a plaintiff's compensation needs to be applied to the payment of legal fees, either in the context of an "all in" settlement or in order to pay the difference between party-party and solicitor-client costs after judgment.

5.45 In our submission this rationale does not justify a blanket prohibition on contingency fees in class actions involving personal injury claims. In a class action context involving the aggregation of a large number of claims, there will ordinarily be economies of scale in relation to the plaintiff lawyer's fees, and the plaintiff lawyer's fees will in any case also be subject to the Court's approval.

5.46 Rather than maintaining a general ban on contingency fees in personal injury based class actions, in our submission the preferable approach is for the Court to retain a discretion as to whether contingency fees are appropriate in any particular class action. In our view class members' interests will be adequately protected as a result of Proposals 5-2 and 5-3, which require the Court's leave before a class action may be conducted on a contingency fee basis and which empower the Court to reject, vary or set the percentage of a contingency fee.

5.47 In addition, if a personal injury based class action is settled for a global sum inclusive of costs, some portion of the settlement sum will necessarily be deducted for the payment of legal costs. It does not matter whether this deduction occurs as a result of conditional fee arrangements or as a result of contingency fee arrangements, provided that the overall amount of costs is reasonable and appropriate. In either case the deduction would occur regardless of the underlying purpose of damages in personal injury claims. For example, if a personal injury based class action settles for $100m including costs, in numerical terms it would make no difference to class members whether legal costs were deducted on the basis of a 15% contingency fee, or on the basis of $15 million having been incurred on a time-cost basis. And in deciding whether to approve legal costs in a proposed settlement on the basis of a contingency fee arrangement or on a time-cost basis, in either case the Court will need to consider whether the proposed settlement distribution mechanism takes appropriate account of any need for repayment of statutory or contractual payment obligations, such as private health insurers or Medicare.

5.48 Revisiting our comments above at paragraph 5.19 in relation to the potential for contingency fees to address an unmet need for funding and legal services in certain types of class actions, we also note that third party funders' investment policies do not appear to favour claims for personal injury compensation.[77]

5.49 Finally, we consider that the use of contingency fee arrangements has the benefit of providing a more transparent and predictable basis for determining the remuneration of the lawyers conducting the case. In our experience class members in personal injury cases often perceive this to be a benefit, rather than being informed that legal fees will be determined on the basis of hourly rates and with total legal fees being largely uncertain until the conclusion of the case.

5.50 *Secondly*, the ALRC's Discussion Paper refers to the fact that contingency fees for competition matters are prohibited in England and Wales on the basis that very large settlements may be generated in this type of class action. Competition law claims are relatively uncommon as class actions in Australia, and those that have been conducted to date have resulted in settlements that are significantly more modest than the example given in the ALRC's Discussion Paper.[78]

5.51 Again to use the example in the ALRC's Discussion Paper, if a competition law class action were settled for £14 billion (or $14 billion) and the plaintiff lawyer proposed to charge a contingency fee, the Court would be confronted by the prospect of the lawyer receiving windfall profits, depending on the contingency fee percentage, the amount of legal work involved and the risk assumed by the plaintiff lawyer. However in our submission this should be addressed on a case by case basis, particularly having regard to the proposal as to the Court's power in Proposal 5-3. Although we do not support a rigidly applied sliding scale for contingency fees (as discussed below in answer to Question 5-2), we do accept that one of the factors which the Court would consider in determining whether to approve any proposed contingency fee is the amount of any settlement.

5.52 In conclusion, in our submission it is preferable for the Court to be able to take a flexible approach and therefore have the discretion to reject contingency fees in a

[77] For example, see the discussion of the investment protocols of IMF Bentham discussed in J Walker, S Khouri and W Attrill, "Funding Criteria for Class Actions" (2009) 32(3) *UNSW Law Journal* 1036, 1047-9.

[78] See for example the Amcor / Visy cartel class action ($121 million), Air cargo cartel class action ($38 million), Vitamins cartel class action ($30.5 million) and Rubber chemicals cartel class action ($1.5 million). As far as we are aware, no cartel class action has been commenced since 2007.

particular case, rather than mandating a general prohibition for certain types of class action. The issues raised by the ALRC in relation to personal injury matters and competition matters would be adequately addressed on a case by case basis as a result of other reform proposals including Proposals 5-2 and 5-3.

> **Proposal 5-3** The Federal Court should be given an express statutory power in Part IVA of the *Federal Court of Australia Act 1976* (Cth) to reject, vary or set the commission rate in third-party litigation funding agreements.
>
> If Proposal 5–2 is adopted, this power should also apply to contingency fee agreements.

Third party litigation funding agreements

5.53 There is developing jurisprudence to the effect that the Court already has the power under existing provisions of Part IVA to vary a litigation funder's commission: see for example *Earglow Pty Ltd v Newcrest Mining Ltd* [2016] FCA 1433 at [7]; *Blairgowrie Trading Ltd v Allco Finance Group Ltd (receivers and managers appointed) (in liquidation) (No 3)* [2017] FCA 330 at [101]; *Mitic v OZ Minterals Ltd (No 2)* [2017] FCA 409 at [26]-[31]; *HFPS Pty Ltd (Trustee) v Tamaya Resources Ltd (in liquidation) (No 3)* [2017] FCA 650 at [105]; *Perera v GetSwift Ltd* [2018] FCA 732 at 365; although there remains some doubt about the issue as was recently noted by Lee J in *Clarke v Sandhurst Trustees Ltd (No 2)* [2018] FCA 511 at [12].

5.54 In addition it is accepted that the Court has the power to determine the percentage commission payable to a litigation funder in the context of a common fund order: *Money Max Int Pty Ltd v QBE Insurance Group Ltd* [2016] FCAFC 148; *Blairgowrie Trading Ltd v Allco Finance Group Ltd* [2017] FCA 330 at [96], [118]-[123]. Since the seminal judgment of the Full Court in *Money Max v QBE*, common fund orders rapidly became an established feature of funded class actions, particularly in relation to shareholder claims, and are now commonly sought in the context of those claims: for example, *Blairgowrie Trading Ltd v Allco Finance Group Ltd* [2017] FCA 330; *Caason Investments Pty Ltd v Cao (No 2)* [2018] FCA 527; *McKay Super Solutions Pty Ltd (Trustee) v Bellamy's Australia Ltd* [2017] FCA 947 at [22]; *Hall v Slater & Gordon Ltd* (proceeding VID1213 of 2016).[79]

5.55 Statutory clarification of the Court's power to vary commission rates is a logical extension of these jurisprudential developments.

5.56 It may, however, introduce a degree of uncertainty and timidity in the litigation funding market, at least for a period of time as the practical application of this type of provision evolves and the principles become settled. Despite the developing jurisprudence that was noted above in relation to the Court's power to vary a litigation funder's commission (in the absence of a common fund order), we are not aware of any

[79] See transcript of proceedings on 16 November 2017 and 14 December 2017.

instances where the Court actually proceeded to vary a funder's commission and, in doing so, espoused its reasoning and any principles to be applied.

Contingency fee agreements

5.57 As will be clear from our submissions above in relation to other aspects of the proposed reforms concerning contingency fees, we accept and agree that it is appropriate for the Court to have the power to reject, vary or set the percentage of any applicable contingency fee arrangements. In our submission such a power would be consistent with the supervisory role of the Court, and would protect class members from misuse of contingency fee arrangements and unfairness in their application. This would include an avoidance of windfall gains to lawyers and disproportionality between work done and risk undertaken by plaintiff lawyers and their financial reward for that work and risk. The power to vary the percentage of a contingency fee is also consistent with our submission above in relation to the power to vary a funder's commission rate, and taking into account that contingency fees and third party funding arrangements are alternative funding mechanisms which have conceptual similarities.

> **Question 5-2** In addition to Proposals 5–1 and 5–2, should there be statutory limitations on contingency fee arrangements and commission rates, for example:
>
> - Should contingency fee arrangements and commission rates also be subject to statutory caps that limit the proportion of income derived from settlement or judgment sums on a sliding scale, so that the larger the settlement or judgment sum the lower the fee or rate? Or
> - Should there be a statutory provision that provides, unless the Court otherwise orders, that the maximum proportion of fees and commissions paid from any one settlement or judgment sum is 49.9%?
>
> **Question 5-3** Should any statutory cap for third-party litigation funders be set at the same proportional rate as for solicitors operating on a contingency fee basis, or would parity affect the viability of the third-party litigation funding model?

5.58 Although we support Proposals 5-1 and 5-2 and we also support the Court having the power to vary, reject or set the percentage of any funder's commission or lawyer's contingency fee, in our submission a prescriptive sliding scale should not be introduced as part of any reforms relating to litigation funding and legal costs.

5.59 In our submission it is important that commission rates and contingency fees are proportionate, however the concept of proportionality involves more than simply comparing the amount payable to funders and lawyers with the overall resolution sum. This has been recognised in a number of judgments of the Court in the course of considering the proportionality of legal costs, including in *Earglow Pty Ltd v Newcrest Mining Ltd* [2016] FCA 1433 at [99] and *Caason Investments Pty Ltd v Cao (No 2)*

[2018] FCA 527 at [148]. In *Blairgowrie Trading Ltd v Allco Finance Group Ltd* [2017] FCA 330, Beach J said at [181]:

> But what is claimed for legal costs should not be disproportionate to the nature of the context, the litigation involved and the expected benefit. The Court should not approve an amount that is disproportionate. <u>But such an assessment cannot be made on the simplistic basis that the costs claimed are high in absolute dollar terms or high as a percentage of the total recovery</u>. In the latter case, spending $0.50 to recover an expected $1.00 may be proportionate if it is necessary to spend the $0.50. In the former case, the absolute dollar amount as a free-standing figure is an irrelevant metric. The question is to compare it with the benefit sought to be gained from the litigation. Moreover, one should be careful not to use hindsight bias. The question is the benefit reasonably expected to be achieved, not the benefit actually achieved. Proportionality looks to the expected realistic return at the time the work being charged for was performed, not the known return at a time remote from when the work was performed; at the later time, circumstances may have changed to alter the calculus, but that would not deny that the work performed and its cost was proportionate at the time it was performed. Perhaps the costs claimed can be compared with the known return, but such a comparison ought not to be confused with a true proportionality analysis. Nevertheless, any disparity with the known return may invite the question whether the costs were disproportionate, but would not sufficiently answer that question [emphasis added].

5.60 A mandatory sliding scale would in our view involve a simplistic assessment of what is reasonable and proportionate in the context of any given case, and we agree with the ALRC's description of one of the criticisms of sliding scales, which is that it is "too blunt an approach that does not allow for differences of risk in individual cases".[80]

5.61 In putting forward Proposal 5-1, the ALRC recognises that a contingency fee would be paid to cover fees and disbursements and also, importantly, to reward risk. That risk includes the risk of losing the case and the associated risk of being required to pay the defendant's costs. This risk will vary from case to case and will not simply be a function of the overall resolution sum. In broad terms it would be expected that, as the Full Court observed in *Money Max v QBE*,[81] a very large settlement might justify a lower funding commission rate so that the amount paid to the funder would be proportionate to the risk the funder assumed. However the size of the settlement should not be the only consideration, as would be the case if a sliding scale were introduced.

5.62 Relatedly, a sliding scale would also fail to take into account:

(a) the manner in which the case was defended – knowing that a case was being conducted on a contingency fee basis, a defendant might have an interest in tactics of delay and attrition in an attempt to generate high levels of work by the plaintiff lawyer and thereby ultimately render it uneconomical for the plaintiff to continue pursuing the case;

[80] Discussion Paper, [5.70].

[81] *Money Max Int Pty Ltd v QBE Insurance Group Ltd* [2016] FCAFC 148, [86]-[89].

(b) the stage the proceeding had reached before it was resolved – a settlement that is agreed several years after commencement of the proceeding and after a lengthy trial would, logically, justify a higher commission rate or contingency fee;

(c) solvency risk and the ability of the respondent (and/or any insurer) to ultimately pay a verdict, award or settlement;

(d) non-monetary aspects of any proposed settlement, such as for example, the giving of an apology.[82]

5.63 These are relevant considerations, particularly in relation to contingency fees, because they affect the amount of legal work that needs to be carried out by the plaintiff lawyer as well as the risks assumed by the plaintiff lawyer.

5.64 We also make the observation that the introduction of a sliding scale could itself create conflicts of interest in the ways that it might incentivise funders or lawyers to resolve cases.

5.65 The concept of proportionality therefore involves broader consideration of the reasonableness of the commission rate or contingency fee in light of various features of the case and the context and manner in which it was resolved. Instead of enshrining a rigid and prescriptive approach such as a sliding scale which only takes into account the proportionality of the commission rate or contingency fee when compared to the resolution sum, in our submission the Court should retain a discretion to vary or set a commission rate or contingency fee after carrying out a broader inquiry as to proportionality. Such an inquiry could be guided by the introduction of general principles or factors which the Court would be required to consider in determining whether a commission rate or contingency fee is proportionate, including:

(a) the resolution sum;

(b) the aggregate amount in dispute, if it is able to be reliably estimated or determined;

(c) the risks of establishing liability, loss or damage;

(d) any significant procedural risks, such as the likelihood of an order under section 33N of the *Federal Court of Australia Act*;

(e) the duration of the litigation and the stage at which it was resolved as well as the defendant's conduct of the litigation;

(f) the amount (if any) advanced by way of security for costs;

5.66 In addition, we do not oppose the introduction of a statutory maximum that would mean that class members receive at least 50.1% of any resolution sum, provided that any such statutory maximum is structured as a rebuttable presumption and the Court

[82] As contained in the proposed settlement notice regarding the class action arising from events on Palm Island: http://www.fedcourt.gov.au/__data/assets/pdf_file/0005/49523/24-Apr-2018-Settlment-Notice.pdf

retains a discretion to allow a higher amount, for example on the basis of the factors listed above.

5.67 The introduction of a rebuttable presumption regarding a statutory maximum might encourage better practices among lawyers and funders in selecting the most appropriate funding structure for any given case. For example, in our view the suboptimal outcomes for class members in *Clarke v Sandhurst* and in *Caason v Cao* might have been avoided if those cases had been funded by means of contingency fee arrangements rather than by third party litigation funders.

5.68 Finally, in answer to Question 5-3 we consider that any statutory cap (subject to a rebuttable presumption) should be set at the same proportional rate for contingency fees and litigation funding commissions because this will create a level playing field between the two alternative funding models and thereby encourage competition.

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

5.69 We would support the creation of a fund for meritorious class actions that do not otherwise attract private funding from litigation funders or lawyers through contingency fees.

5.70 As we also submitted to the VLRC in the context of its recent inquiry, such a fund could be financed by levying 1% of all contingency fees and litigation funding commissions in successful class actions. We agree that such a fund could be administered by a board, potentially located within the Public Interest Advocacy Centre or another similar entity with a public interest litigation remit, which would assess the merits of applications for funding.

6. COMPETING CLASS ACTIONS

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

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

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

General observations – the phenomenon of "competing" class actions

6.1 We agree that there is a need for *ex ante* procedural mechanisms for the orderly coordination of competing, overlapping, or substantially similar class actions involving a common respondent. *Ad hoc* treatment of competing class actions when and as they arise generates uncertainty, can be costly and time-consuming, and can encourage strategic behaviour (such as the race to the courthouse or forum-shopping) that is not in the interests of justice, as law firms and litigation funders compete for exclusive carriage of proceedings.

6.2 In considering reforms aimed at providing such mechanisms, particularly if amendments to Part IVA are being contemplated, it is important to consider what might appear to be an upward trend in competing class actions in the overall context of class actions over time:

(a) historically, competing class actions have been relatively infrequent,[83] and where they have occurred, they have not generated insuperable case management difficulties;

(b) currently competing class actions remain unusual, despite a recent but still relatively small series of competing shareholder class actions (including the high profile claims against GetSwift and AMP).

[83] Morabito Fifth Report, 40.

6.3 Considered in that context, it is unlikely that the wholesale amendments of Part IVA contemplated by Proposal 6-1 would prove to be beneficial for all stakeholders – and particularly for class members – and, in fact, may exacerbate some of the emerging negative consequences of competing class actions.

6.4 One concern is that because the nature, extent, and likely frequency of competing class actions are not yet clear, such significant changes to the enabling legislation are premature, and may not be adequate to address issues that arise as the phenomenon of competing class actions develops over time.

6.5 A more immediate concern, is that, to the extent competing class actions are increasing in frequency and may be expected to continue to do so, it is predominantly shareholder class actions that are affected. Although it is largely responsive to a phenomenon that is confined to shareholder class actions, Proposal 6-1 would apply to *all* class actions, without regard to important differences between shareholder cases and, for example, product liability cases involving personal injury claims that might make a solution developed for shareholder class actions unnecessary, ineffective, or counter-productive in a product liability case.

6.6 Having regard to the above, we do not support Proposal 6-1, but we would be supportive of an amendment to the Federal Court of Australia's Class Action Practice Note (GPN-CA) to provide further case management procedures for competing class actions based on the following overarching principles:

(a) the procedures should be sufficiently flexible to accommodate different kinds of class actions and the specific circumstances of particular cases;

(b) the interests of class members must be paramount, and those interests must be considered in their totality;

(c) group member engagement with the proceedings should be encouraged, and lawyers' and funders' accountability to class members increased; and

(d) the Court's ability to oversee and control legal costs should be optimised.

Specific comments on Proposal 6-1

6.7 As noted above, Proposal 6-1 is premature and overbroad, and is therefore not well-suited to address a phenomenon that is still emerging and is largely confined to shareholder class actions. Beyond those general concerns, however, certain features of Proposal 6-1 may in fact exacerbate the negative consequences of competing actions that have become apparent in shareholder cases.

The monopoly problem

6.8 Essentially, the first two components of Proposal 6-1 mandate a default position in which one law firm or law firm/funder combination *must* be granted, in effect, a monopoly to conduct the proceedings. The combination of mandatory open classes, and the presumption that only one proceeding will continue, would make the threshold determination of which proceeding should continue the defining event of the proceedings. At the same time, the capacious definition of "competing class actions" ("non-theoretical possibility that a person may be a class member in more than one class action"), would operate to expand and extend the group that would ultimately be bound by results of the proceeding as far and wide as possible, regardless.

6.9 Framing Proposal 6-1 as a mandatory monopoly makes it possible to consider how it may lead to unintended consequences that would exacerbate some of the issues that have prompted proposals for reform.

6.10 *First*, it rests on the premise that the "open class" in any given proceeding or group of proceedings is essentially monolithic, and therefore is as well served by one proceeding as another. That premise is mistaken. Open class definitions do not include a closing criterion (usually based on having executed a particular costs or funding agreement). But the open class itself is nonetheless constituted and circumscribed by the substantive nature of the claims advanced on its behalf and the overall composition of the group.

6.11 *Secondly* and more fundamentally, Proposal 6-1 contemplates a winner-takes-all contest at the very threshold of a case, when only limited substantive information may be available, with sole carriage of proceedings for the widest possible class as the prize. Raising the stakes of the *competition* for the class action (to the detriment of the class action itself) is productive of significant risk of perverse incentives, as competing law firms and litigation funders may be compelled to focus their efforts and resources on winning the threshold competition, rather than on developing strategies for pleading and pursuing a case on its merits. Proposal 6-1 may therefore encourage rather than constrain strategic behaviour that has marked recent proceedings, including the following:

(a) the race to the courthouse, with the consequent problems of inadequate investigation, poor pre-commencement analysis, and few if any genuine steps towards early resolution;

(b) extravagant and overbroad pleadings designed to exaggerate case value or to manufacture a putative competitive advantage by appearing to represent the biggest possible group over the longest possible claim period;

(c) unsubstantiated public commentary by lawyers or litigation funders about the value of the claims they intend to pursue;

(d) unrealistic litigation budgets (without any guarantee that they will not be revised); and

(e) tactical delay (lying in wait) until other proceedings have been commenced and funding and other terms announced, and then filing (or even announcing an intention to file) copy-cat proceedings based on statements of claim in proceedings on foot, but doing so with the advantage of being able to make the last bid on price.

6.12 Proposal 6-1 does, of course, allow for an exception to the presumptive monopoly. But, as a practical matter, the default position is likely to remain undisturbed in all but very unusual cases:

(a) default positions generally have the benefit of inertia;

(b) the proposed statutory standard for the invoking the exception is, on its face, stringent;

(c) the burden of establishing that the exception should be exercised is likely to be considerable, particularly given that at the outset of proceedings there would be little evidence to support an application that the default position would be antithetical to the interests of justice;

(d) given the limited prospects of invoking the exception, there would be little incentive for law firms and litigation funders to pursue the exception; and

(e) as the non-stayed case proceeds, for reasons of efficiency it would become increasingly difficult to justify displacing it with a case that had been stayed throughout.

6.13 There are also, of course, other constraints on strategic behaviour elsewhere in Part IVA (particularly section 33V) as well as those inherent in the potential for adverse costs exposure (or other consequences) resulting from incautious pleading. In practice, however, those constraints would be of limited utility:

(a) given the expectation that most cases will settle, the adverse costs exposure of careless or overly-broad pleadings may rarely crystallise;

(b) the broad range of reasonableness against which settlements are measured makes most objections difficult to sustain (and imposes costs and some risks on the objector); and

(c) once carriage is taken of a case, there is little to constrain upwards revisions to budgets proposed at the threshold as the scope and amount of reasonably necessary legal work becomes apparent as the case proceeds.

6.14 Reversing the default position in Proposal 6-1 would ameliorate these concerns to some extent. That is, the threshold inquiry would be whether the two (or more) actions are, in fact, competing (rather than overlapping), and whether the interests of justice would be served by allowing only one to proceed. However, a revision of that nature would be, at best, only a partial solution.

6.15 For these reasons, we do not consider Proposal 6-1 an appropriate mechanism for addressing competing class actions and we submit that it may be counter-productive. As noted above, we do support an augmentation of the Practice Note, as outlined and discussed below beginning at paragraph 6.44.

Managing legal costs

6.16 Considered independently of the first two components of Proposal 6-1, the third and fourth components would considerably reinforce the Court's ability to control the legal costs and the amounts paid to litigation funders. To that extent, we support those objectives.

6.17 We submit, however, that the costs-related components of Proposal 6-1 are neither the optimal approach nor free of unintended negative consequences:

6.18 *First*, making litigation funding agreements enforceable only with approval of the Court, would almost certainly lead to decreased availability of litigation funding, with a corresponding decline in the access to justice that litigation funding can provide.

6.19 *Secondly*, common fund treatment of funding and costs agreements may be appropriate in many cases, but mandating its application in all cases not only runs the risk of overbreadth, but also threatens to exacerbate the "monopoly problem" because it rewards the successful lawyers and funders with the broadest possible claimant group.

6.20 We note that permitting contingency fee arrangements in class actions would achieve the objectives of Proposal 6-1 and would, in fact, afford Courts the greatest degree of control over legal costs and, indirectly, funding costs. We refer to our submission above in this regard.

Overarching principles for managing competing class actions

6.21 Proposal 6-1 is of course concerned with the interests of class members, but in focusing only on costs and funding agreements, it reflects too narrow a view of what those interests are.

Class members' preferences should be considered

6.22 Proposal 6-1 fails entirely to take into account the preferences of class members as to who their legal representatives should be. Proposal 6-1 rests on the premise that class members are essentially agnostic (other than with respect to costs and commission rates). That premise is false; class members can and frequently do have and act on preferences between notionally competing proceedings, and while the reasons vary depending on the nature of the case, giving effect to those preferences does much to avoid both the perception and potential reality of class actions being lawyer- and funder-driven enterprises.

6.23 In cases involving injuries or traumatic circumstances, the relationship between individual class members and their legal representatives can become highly personal, it can be a key determinant of a group member's willingness to participate in the proceedings, which may include providing personal medical information, giving evidence, and making affidavits attesting to often traumatic experiences. In such cases, the personal nature of the relationship between class members and their legal representative should be respected, and depriving class members of their preference may discourage vulnerable class members from pursuing meritorious claims.

6.24 In shareholder class actions, where competing actions are most likely to arise, it is similarly the case that class members are far from agnostic. In fact, class members in shareholder class actions are particularly well-placed to evaluate and discriminate between competing proposals, and they are accustomed to expressing their preferences accordingly.

6.25 This is particularly the case with institutional class members, who usually comprise the majority by value of the class in most shareholder cases. Most institutions are repeat players in shareholder class actions, and are sophisticated claimants for whom the decision to participate in a class action – or in which class action to participate – is a strongly informed decision, which is often made (or recommended) by in-house lawyers. And institutional investors have considerable experience of competing actions and/or book builds (as discussed below, the process in which law firms and litigation funders enter into costs and funding agreements with class members prior to commencing proceedings). As a result, it is not unusual for institutions to:

(a) require a presentation of the merits of the case by the lawyers proposing to act for the class;

(b) provide trade data and request a preliminary loss estimate and an articulation of the methodology underlying the estimate;

(c) negotiate (or seek to negotiate) different terms in costs and funding agreements;

(d) conduct formal due diligence inquiries into the proposed litigation funder;

(e) require a side letter that addresses particular issues, such as confidentiality provisions, costs implications, and “most favoured nation” provisions assuring the institution that no other claimants will receive – on a like-for-like basis – more favourable terms than those to which it agrees; and

(f) in some cases, openly ask why they should choose one firm/funder combination over another.

6.26 These aspects of the way in which shareholder class actions, including potentially competing actions, have evolved illustrate that class members’ preferences should be given weight, and any reforms should not introduce a structure that, purporting to be in class members’ economic interests, excludes their rationally exercised preferences.

Class members’ economic interests must be considered in their totality

6.27 At the outset of any proceedings, there may be few reliable data points available by which to measure which of several competing proposals offers class members the greatest economic benefits. The paucity of information can lead to a reductive analysis in which, for want of a better term, the only consideration is “price”, broadly understood as the lawyers’ rates, the proposed amount of disbursements, and the litigation funder’s commission rate.

6.28 Isolating "price" as the sole, or even predominant, factor, however, is not only unreliable as a method for measuring class members' economic interests, it also threatens to work against class members' interests by creating a spurious correlation between class members' *recovery* (the net amount that they *do* get) with the *price* paid to lawyers and funders (the amount that they do *not* get). The risk of that spurious correlation taking hold is not just theoretical; as recent proceedings have illustrated when competing shareholder class actions are on foot (or proposed), the competition can devolve into what can only be described as a price war, with competing funders offering ever-lower commission rates.

6.29 The correlation is spurious because, while price is, of course, relevant, the predominant determinant of class members' net recovery is the gross recovery. In arithmetic terms, the denominator is far more important than the numerator. Consider competing scenarios A and B in which the price, both in terms of legal costs and the commission rate, is 20% higher in scenario B than those in scenario A.

	Scenario A	**Scenario B**
Legal costs	$8m	$9.6m
Commission rate	15% on net (gross less costs)	18% on net (gross less costs)

6.30 Assuming a resolution sum of $60 million in scenario A.1, the table below illustrates that a 7% increase in the gross resolution sum (in scenario B.1) generates a better return to class members, despite the fact that prices were 20% higher in scenario B.1. In terms of the net recoveries of class members, the difference between scenarios A and B increases as the gross resolution sum increases, as illustrated in scenario B.2 compared to scenario A.2.

	A.1	**B.1**	**A.2**	**B.2**
Gross recovery	$60m	$64.2m	$100m	$107m
Legal Costs	$8m	$9.6m	$8m	$9.6m
Commission	$7.8m	$9.83m	$13.8m	$17.53m
Class members	$44.2m	$44.77m	$78.2m	$79.87m

6.31 Assuming, as is most likely, that the recovery in either case was the result of a settlement, *ex post* scrutiny of the settlement amount in scenarios A.1 and A.2 is in practice unlikely to take place. But even if it did, an objection that a settlement of $100 million should not be approved because it might have been possible to have obtained a settlement that was 7% higher is unlikely to be sustained. And, in fact, even greater variance would in many cases still fall within the range of reasonableness.

6.32 Unless it is assumed that gross recoveries will be all but identical regardless of how a case is prosecuted and by whom, which would be a flawed assumption, these simple examples illustrate that price alone is a poor indicator of ultimate recovery, or at the very least it provides an incomplete picture.

6.33 It is difficult accurately to predict at the outset of a case what might ultimately be recovered, but in a properly prepared and analysed case it is not impossible to make informed projections that may be of considerable utility to Courts when considering the economic benefits offered to class members by competing actions. And in all but highly unusual circumstances, class members' economic interests will be far more sensitive to variations in gross recovery than to price differences. Focusing excessively, let alone exclusively, on price terms is more likely than not to work against them.

Group member engagement is beneficial and should be encouraged

6.34 As class actions in Australia have evolved, the economic model that has emerged has stimulated an unusually high degree of active group member engagement with proceedings. In proceedings premised on financial losses – and most particularly in shareholder cases – the participation of litigation funders whose relationship to the proceedings is contractual has led to the widespread practice of what is known as the "book build", in which class members are invited to register with a law firm or funder and enter into costs and funding agreements.

6.35 The book build, in turn, gave rise to the phenomenon of the closed class – that is, the class definition criteria include having entered into specific retainer or funding agreement. However, book builds are typically undertaken even in open class proceedings, and open classes comprising both funded and unfunded claimants are now common, and a variety of judicially-developed mechanisms have been deployed – funding equalisation orders and common fund orders, for example – to ensure equal treatment among class members.

6.36 While originally a function of the economics of litigation funding, the book build process has become an important part of the class action landscape, and it has produced a culture of group member engagement in which many class members are likely to be aware that proceedings affecting their legal rights are on foot before a settlement is reached and they receive a notice to that effect.

6.37 In contrast to class action regimes in which cases can be commenced with little or no outreach to class members, book building requires at a minimum an affirmative expression of interest from a critical mass of potentially affected class members and has been an important bulwark against the proliferation of cases driven primarily by lawyers and funders who identify a single lead applicant and commence proceedings regardless without regard to whether the potentially affected class is likely to be supportive of the proceedings.[84]

[84] In the United States, where the class action regime and costs provisions have not generated anything like the same degree of group member engagement, there has been considerable academic commentary, as well as important law reforms, aimed at improving the "governance" of class actions by increasing participation and engagement by class members. See for example E Cabraser and S Issacharoff, "The Participatory Class Action" (2017) 92 NYU L Rev 846; EC Burch, "Governing Securities Class Actions" (2011) 80 U Cin L Rev 299; EC Burch

6.38 As discussed above, class members are not as a rule agnostic as to the lawyers they would like to represent them in class proceedings, and the book build process is forum in which those preferences are developed and expressed. But as well as allowing individual class members to engage with the proceedings, the aggregated book build process provides a structure within which the aggregated benefits are greater than the sum of the individual parts:

(a) in shareholder cases particularly, presentation to sophisticated claimants in a privileged context is an important testing ground for potential cases, and discourages over-ambitious or imprudent claims;

(b) lawyers' accountability to class members is enhanced by having executed costs agreements and retainers with substantial numbers of class members;

(c) the formal retainer between the lawyers and class members allows for a greater degree of substantive communication with class members on a confidential basis; and

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"Optimal Lead Plaintiffs" (2011) 64 Vand L Rev 1109; JC Coffee Jr, "Class Action Accountability: Reconciling Exit, Voice, and Loyalty in Representative Litigation" (2000) 100 Col L Rev 370.

In terms of law reform, most notable are the provisions of the Private Securities Litigation Reform Act of 1995 (**PSLRA**) governing the appointment of the lead plaintiff and lead counsel where there are competing applicants and lawyers. The PSLRA creates a rebuttable presumption that "most adequate lead plaintiff . . . is the person or group of persons that . . . in the determination of the court, has the largest financial interest in the relief sought by the class" (subject to certain procedural requirements and the provisions of Rule 23 of the Federal Rules of Civil Procedure, the rule that enables and governs all class actions in Federal Courts). The PSLRA further provides that "the most adequate lead plaintiff shall, subject to the approval of the court, select and retain counsel to represent the class." The legislative history of the lead plaintiff provisions, academic commentary on them, and the substantial body of jurisprudence applying them, emphasise that the purpose of the lead plaintiff provisions was "to ensure that securities litigation was investor-driven, as opposed to lawyer-driven," to "empower investors so that they-not their lawyers-exercise primary control over private securities litigation," and "to permit the plaintiff to choose counsel rather than having counsel choose the plaintiff." *In re Initial Public Offerings Securities Litigation*, 214 F.R.D. 117, 123 (S.D.N.Y. 2002) (internal citations to legislative history omitted). See also Burch, "Optimal Lead Plaintiffs" cited above. The fundamental premise of the lead plaintiff provisions is that the greater the lead plaintiff's financial interest in in the litigation, the more likely they are to have incentives to monitor and supervise their lawyers.

An analogous practice in the United States has developed in what is known as multi-district litigation (**MDL**), which is governed by a set of judicial rules designed specifically to address situations in which competing cases arising from the same circumstances (some of which may themselves be class actions) are filed in different federal jurisdictions. Through the MDL process, a panel of judges assigns all of the cases to a single court. The cases are not formally consolidated into one case, but for most purposes – discovery, motions practice, trial of common issues – they are treated collectively. Under the MDL rules, the Court appoints one lawyer from one of the cases as MDL Lead Counsel (occasionally, co-leads are appointed), usually supported by a Plaintiffs Steering Committee (**PSC**) made up of some but not necessarily all of the lawyers from other cases. MDL Lead Counsel coordinates and assigns work among lawyers on the committee, and because most cases involve contingency fees, the costs awarded are proportional to the result, and then allocated among the lawyers, usually by agreement among them based on the work performed. The MDL rules do not mandate appointing the firm with the biggest case inventory as MDL lead counsel (and/or to the PSC), but it has emerged as a consideration and often plays a part in private ordering among firms with cases that are transferred to a single MDL. Many large MDL proceedings are in areas of law where class actions are prohibited – injuries arising from defective products, for example, such as the litigation involving knee and hip implants) and it is often the firm with largest number of clients that serves as MDL Lead Counsel. It has been suggested that that approach be formalised in a similar manner to the presumption under the PSLRA, again based on the proposition that lawyers' accountability increases proportionally to the financial interests of their clients. See C Silver and G Miller, "The Quasi-Class Action Method of Managing Multi-district Litigations: Problems and a Proposal" (2010) 63 Vand L Rev 107.

(d) the distribution of both routine communications and mandatory notices is made more efficient and less costly, which reinforces other important procedural safeguards (such as opt out and settlement objections).

6.39 In shareholder cases, the book build process is also a critical element of any proper analysis and investigation of materiality and quantum of loss, and there are significant advantages to conducting a robust book build during the investigation phase:

(a) the collection and analysis of trade data from identified class members at an early stage – and ideally pre-commencement – facilitates a more reliable analysis of potential quantum, without which it is impossible to take any genuine steps towards early resolution. More broadly, the collection and analysis of trade data will be required for any form of resolution of a shareholder class action (other than a resolution entirely in favour of the respondent). Settlement cannot be achieved (nor settlement proceeds distributed) without a reliable quantification of actual group members' individual and aggregate losses, which requires collecting and analysing trade data. If the case resulted in a judgment in favour of the class, the same collection and analysis would be a necessary element of any award of damages pursuant to the relevant provisions of section 33Z, particularly if the Court were to award damages in an aggregate amount pursuant to section 33Z(1)(f), which is conditional upon a "reasonably accurate assessment" of that amount (section 33Z(3)) and a manner for determining individual group members' entitlement to share in the damages (section 33Z(4));

(b) absent a book build process, advocates run the risk of making statements or claims based on market-wide forms of analysis that are inherently less reliable than analyses based on actual trading data, and typically generate estimates far in excess of actual case value;

(c) in the many shareholder cases run by Maurice Blackburn in which there was a robust book build conducted prior to commencement followed by a class closures, the book build process accounted for the substantial majority of claim value in all but one outlying case which involved unusual circumstances.

6.40 Given these significant advantages, Proposal 6-1 would seem a retrograde step to the extent it would act as a disincentive – or, potentially eliminate – the book build process. Rather than encourage and benefit from group member engagement, it could create an environment in which shareholder class actions would become increasingly driven by lawyers and funders with the support of only a sole group member as lead applicant (advised, perhaps, that Courts have generally allowed applicant reimbursement payments).

6.41 We consider, therefore, that any reforms should not only avoid the potential deleterious effects of Proposal 6-1, but should build upon those aspects of current practice that promote group member engagement.

The ability of the Court to oversee and control costs should be optimised

6.42 As noted above, contingency fee arrangements would not only, based on historical data, produce greater returns to class members, it would also allow the Court plenary control over costs generally.

6.43 In the context of managing competing class actions, the degree of control afforded by contingency fees would:

(a) allow the Court to establish an appropriate rate having regard to the progress and outcome of the case, rather than rates set by contract in funding agreements at or before proceedings are commenced;

(b) give the Court greater discretion to allow cases to consolidate proceedings, or allow them to proceed in parallel, and may lead to productive cooperation among lawyers, because contingency awards could be adjusted to eliminate duplication of costs;

(c) avoid egregious disproportionality in circumstances where legal costs – even if reasonably incurred – ultimately constitute an unacceptably high percentage of overall recovery; and

(d) provide a mechanism for exercising indirect control over funding agreements by allowing some or all of the lawyers' contingency rights (to be determined by the Court) to be assigned to a litigation funder in exchange for part payment of fees, disbursements, or for providing adverse costs indemnity, as noted above at paragraph 5.39.

Alternative proposal

6.44 In our submission Proposal 6-1 is likely to produce risk, may not achieve its intended purpose, and in fact may exacerbate the phenomenon it is designed to address. To the extent, therefore, that Proposal 6-2 is contingent on Proposal 6-1, we do not support it in its current form.

6.45 However we agree that reform may be useful, and consider that an amendment to the Class Actions Practice Note – or a supplementary practice note specific to competing class actions – is a pragmatic solution that may be more easily and effectively implemented.

6.46 Based on the principles discussed above, we offer the following suggestions as an outline for such amendments to the practice note:

(a) Upon commencement of an open class action, time begins to run on a specified period (for example, six months) in which competing, overlapping, or parallel cases must be filed. The first-filed proceedings initiate the period, but otherwise have no procedural or substantive advantage. The time allowed should be long enough to avoid a *de facto* first-to-file rule, but not so long that the proceedings are unduly delayed.[85] At the conclusion of that period, assuming competing cases exist, the cases should be brought together for case management.

(b) The first case management item should then be an assessment of whether the cases are, in fact, competing, having regard not only to class definition, but also the nature and substance of the claims. Respondents should not be heard on these issues because it seems inconsistent with the interests of justice to allow respondents to choose their plaintiffs. The approach taken should be flexible so that, on the one hand, superficial differences (such as tactical use of longer or shorter claim periods) between cases do not preclude a finding that they are "competing" and, on the other hand, that a degree of similarity does not compel a finding that they are competing. Given that in the early stages of proceedings not all issues may be sufficiently clear, the Court should be able to part-hear or defer the determination, and make interim or conditional orders to allow the proceedings to continue in areas that are not dependent on the determination as to competing actions.

(c) If and when the actions are deemed competing, the Court should then make a threshold determination as to the procedural mechanism that would best serve the interests of justice. Contrary to Proposal 6-1, there should be no default position, but rather the Court should have power to make orders ranging from permanent stays of all but one proceeding, ordering the opening or closing of classes, requiring pleading amendments, consolidating cases and ordering various forms of coordination, or allowing the cases to proceed in parallel.[86] Concomitantly, the Court should also be able to make ancillary orders regarding legal costs and litigation funding arrangements to ensure that, if there are inefficiencies or duplication of costs arising from the chosen procedure, they will be remediated in any approval process.[87] As noted above, the availability of contingency fee awards would allow the Court broad discretion in this respect. In addition, as with the previous inquiry, the Court should have the ability to make interim orders to allow the case to proceed if not all relevant issues are sufficiently clear at the outset of the case.

(d) The process for choosing the appropriate mechanism, and determining the roles of the competitors (which may be sole carriage of all proceedings, or none at all) should be designed to avoid to the deficiencies of an *ad hoc* ambulatory

[85] By way of analogy, under the PSLRA, the first filer must publish a notice about the case within 20 days of filing the case, and then any class member can file a motion seeking appointment as lead plaintiff within 60 days of that notice (but they do not need to file). All else being equal, if a movant replaces the plaintiff who filed, that movant then selects class counsel. Where more than one case has been filed and consolidation is pending, the appointment of the lead plaintiff is deferred until the consolidation is decided and must be made "as soon as practicable" thereafter

[86] In several proceedings currently on foot, Courts have in fact varied their approach to ostensibly competing proceedings depending on the particular circumstances, having regard to a range of factors including relative book builds, the nature of the claims, and the conduct of substantive proceedings, including trial of discrete issues. Such proceedings include those against VW, Bellamy's, and Vocation, and there is nothing to suggest that the processes adopted in any of those cases are, or will prove to be, inimical to the interests of justice.

[87] Arguably, the Court has the requisite power under section 33ZF, 33N, and other provisions of the *Federal Court of Australia Act*. It may, however, be useful to include in the Practice Note an illustrative list of mechanisms available to the Court under those provisions, or, if the powers are controversial, to amend Part IVA to articulate express powers.

process and an exclusive focus on price, and should be consistent with the overarching principles discussed above: (1) that class members' interests must be paramount and must be considered in their totality; and (2) group member engagement is beneficial and should be encouraged.

(e) To achieve these objectives, the Court should require simultaneous and sealed applications from each competitor, which would (1) allow greater candour on substantive legal issues which would assist the Court in its determination, and (2) eliminate competitors' ability to "one-up" each other. Among the criteria to be addressed in the application, and to which the Court should have regard, may be the following:

(i) the position of the representative plaintiff and their legal representatives as to the optimal mechanism for coordinating the competing cases, ranging from sole carriage to parallel proceedings, as well as the willingness and ability of the proposed lead plaintiffs and their legal representatives to proceed on a closed class basis and/or work with other plaintiffs and firms (subject to constraints on duplicative costs);

(ii) the experience of the law firms and the lawyers within that firm in running class actions of the kind at issue, as well as the resources available for pursuing the claims vigorously;[88]

(iii) the amount and nature of the work done to investigate and analyse the case;[89]

(iv) an explanation of the certain key elements of the pleading, such as the class period, which would discourage extravagant pleadings that exaggerate claim value;[90]

(v) the expressed preferences of class members, as reflected in the results of any pre-commencement book build, the number of claimants that have entered into a retainer with the lawyers acting for the class, the financial interest of those claimants in the litigation (in a shareholder case, for example, the gross and net number of shares acquired in the class period that were affected by the alleged misconduct),[91] and whether the claims

[88] This and the following point are comparable to certain of the mandatory criteria used to select and appoint class counsel in the US. Rule 23(g) of the Federal Rules of Civil Procedure provides that, in appointing class counsel, the Court *must* consider: (1) "the work counsel has done in identifying or investigating potential claims in the action;" (2) "counsel's experience in handling class actions, other complex litigation, and the types of claims asserted in the action;" (3) "counsel's knowledge of the applicable law; (4) "the resources that counsel will commit to representing the class."

[89] In particular, the emerging practice of competing actions being commenced with statements of claim that simply cut-and-paste from those already filed should be discouraged, if not disqualifying.

[90] Where there are competing proceedings – or competing book builds – it is not uncommon for the later-entering competing law firm or litigation funder to use a longer claim period merely as a tactic to create an impression that group members will recover greater amounts. In fact, given that most cases settle, expanding the claim period on the barest of justifications acts to the detriment of group members with stronger claims.

[91] Taking into account the number of claimants who have retained a particular form and the aggregate value of their financial interest in the litigation is analogous to the presumption in the PSLRA that the most adequate lead plaintiff is the one with the largest financial interest in the litigation (which is generally taken to mean the largest absolute loss).

involve any other compelling reasons not to override class members' choice of representatives;

(vi) in cases involving financial losses – particularly shareholder cases – a realistic estimate of expected net recovery for class members, as well as a structure that constrains and imposes risk on tactical exaggeration of this estimate by lawyers designed to win sole carriage of the proceedings;[92] and

(vii) funding and costs arrangements.

6.47 Another option is for the new requirements of the practice note to leave open the option of the Court, in an appropriate case, appointing a "class member committee" with a remit to select the lawyer who should represent the class and if applicable also the litigation funder who will providing funding. This may not be practical or appropriate in every case involving competing or overlapping claims, however there is utility in leaving open the possibility.

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

6.48 We would support an amendment of the kind contemplated by Question 6-1.

6.49 We do not perceive any compelling substantive need for the amendment, however in practice most shareholder class actions have historically been conducted in the Federal Court of Australia, and we recognise that exclusive jurisdiction would prevent law firms from seeking strategic advantages by commencing proceedings in state courts.

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92 This consideration is arguably paramount, but also most problematic to address. Nonetheless, in a properly prepared case, and particularly when there has been a successful book build, reasonable assumptions can be articulated, and, based on those assumptions, informed estimates of ultimate recovery can be calculated. Incorporating those estimates into the process is necessary if the distortions of focusing only on price are to be avoided, but constraining "over-bidding" as a competitive tactic is difficult. In the U.S., where contingency fees are the rule rather than the exception and there is no adverse costs exposure, courts have employed various kinds of "auctions," to select and appoint lead counsel. In the typical scenario, law firms competing to be appointed lead class counsel (usually in a sealed bidding process), bid a fixed amount (X) that would go to group members free of any deductions for legal costs; that is, the contingency fee the firm would take would apply only to the amount recovered *above* X. In that scenario, proposing too low a figure for X would in all likelihood rule out winning the appointment, but too high an X figure would reduce the contingency award if the recovery was only slightly higher than X, or eliminate it entirely if less than X were recovered. In theory, the winning bid will strike the optimal balance between the economic interests of group members and those of the lawyers, acting as a safeguard against both excessive fee awards and quick, below-par settlements. See, eg, *In re Auction Houses Antitrust Litigation*, 197 F.R.D. 71 (S.D.N.Y 2000). The lead counsel auction is not without controversy, and it would not easily be replicated in the Australian context, but it is an illustration of one mechanism for discriminating between competing cases where the economic interests of group members and the lawyers running the class action can be aligned.

7. SETTLEMENT APPROVAL AND DISTRIBUTION

Preliminary issue: legislating the application of section 33V

7.1 Before dealing with the specific questions and proposals that have been put forward in relation to settlement approval and distribution, we address the preliminary issue raised as to the potential need to legislate the application of section 33V of the *Federal Court of Australia Act*.

7.2 For the reasons identified by the ALRC in its Discussion Paper,[93] we agree that it is unnecessary to introduce reforms that would legislatively enshrine the criteria to be applied in relation to the approval of settlements. In more than 26 years since the commencement of Part IVA, a substantial body of jurisprudence has developed in relation to settlement approvals and the criteria to be applied and considerations to be taken into account.

7.3 We would also add that although the general principles are now seen as well settled, numerous judgments make it clear that there is no definitive or exhaustive list of factors that must or may be taken into account, and that the merits of each settlement should be evaluated in light of the particular facts and circumstances of the case.[94] We also agree that a legislative list of criteria may fetter judicial discretion and stifle the evolution of principles as factual contexts evolve over time.[95] The introduction of a list of legislative criteria might also promote a formulaic "checklist" approach to the consideration of settlement approvals and in our view this should be avoided.

7.4 Countless judgments demonstrate that the Court takes this protective function extremely seriously, perhaps more so than any other aspect of the Court's supervisory role in relation to class actions. In our view it is important that judges retain flexibility and an unfettered discretion in discharging this important aspect of their role in class actions, and it is preferable for the common law to be able to continue to develop and evolve as new issues or unique factual scenarios emerge.

Additional issue: taxation of interest earned on settlement sums

7.5 We also wish to raise an additional issue that is not canvassed in the ALRC's Discussion Paper but which has a direct bearing on the entitlements of class members and in our view ought to be addressed by urgent legislative reform. The issue is the taxation of interest earned on a settlement sum pending distribution to class members.

7.6 Upon settlement of a class action for a global sum, funds ordinarily move as follows:

(a) after signing the settlement agreement, the respondent transfers the settlement sum into an escrow account established by the representative plaintiff's lawyers (to which both the defendant and representative plaintiff's solicitors are signatories), pending approval of the settlement; and

[93] Discussion Paper, [7.6].
[94] See for example *Stanford v DePuy International Ltd (No 6)* [2016] FCA 1452, [114] per Wigney J.
[95] Discussion Paper, [7.5].

(b) after the settlement is approved and settlement administrators are appointed, the applicant's lawyers transfer the settlement sum into a trust account maintained by the settlement administrators pending readiness to make distributions to class members.

7.7 The settlement sum earns interest from the time it is deposited into the escrow account until it is distributed to class members.

7.8 Depending on the type of class action, the duration of the settlement administration process and the amount of the settlement, that interest may be substantial. For example, after the approval of the settlement in the DePuy ASR hip implants class action in June 2016, the respondents transferred the settlement sum of $250 million plus pre-approval interest of more than $879,000. The settlement administration is ongoing, however payments of more than $70 million have been made to class members since the time of the approval, and the settlement sum has accrued more than $8 million in interest.[96] Similarly, in the Kilmore bushfire class action in the Supreme Court of Victoria, more than $30 million in interest accrued on the settlement sum of $494 million. Even in a shareholder class action where the settlement administration process is typically much shorter than in personal injury or property damage claims, the interest may be substantial; for example, more than $1.1 million in interest was earned on the settlement sum in the Centro class action.

7.9 The interest earned on the settlement sum ought to be available in its entirety for the benefit of class members, and be applied in the first instance to payment of the costs of administering the settlement, and any remainder should be paid to class members.

7.10 This would be consistent with the position at common law, at least in respect of compensation for personal injuries, that pre-judgment interest does not attract liability for income tax;[97] and the statutory exemption from payment of tax on interest on a judgment debt following an award of damages for personal injury under section 51-57 of the *Income Tax Assessment Act 1997* (Cth).

7.11 Alternatively, any net income after payment of administration costs should be taxed not in the hands of the scheme administrator, but only in the hands of group members at their own marginal tax rate following distribution.

7.12 Presently there is uncertainty as to whether:

(a) the interest is assessable income for the purpose of taxation legislation; and

(b) if the interest is assessable income, whether the costs of the settlement administration are deductible expenses.

7.13 If the interest is assessable income and to the extent that administration costs are not deductible expenses, tax is liable to be paid at the highest marginal tax rate of 45% in accordance with section 99A of the *Income Tax Assessment Act 1936* (Cth) (because until immediately prior to distribution, it is generally not possible,

[96] Affidavit of Julian Klaus Schimmel dated 20 June 2018, [23], filed in proceeding NSD 213 of 2011.
[97] *Whitaker v FCT* (1998) 82 FCR 261; 153 ALR 334; 38 ATR 219; (1998) Aust Torts Reports ¶81-467.

consistently with the terms of the applicable settlement distribution scheme, for any beneficiary or beneficiaries to be made 'presently entitled' to a share of the income of the scheme). This has the potential to erode substantially an amount of interest that in our view should be available for the benefit of class members. It also means that settlement interest is taxed differently depending on whether settlement administration can be concluded within one financial year or spans more than one year (in which case the issue of present entitlement arises). This is unfair to class members.

7.14 In addition, the settlement administrator commonly incurs costs in dealing with taxation issues on behalf of group members. This includes the engagement of specialist tax advisers by the settlement administrators, which further erodes the amounts that are ultimately available for the benefit of class members.

7.15 The issue will be tested in the Court in proceeding VID 335 of 2018, which is an appeal by the trustee of the settlement fund in the Murrindindi bushfire class action against the Commissioner of Taxation's decision to disallow an objection to an assessment requiring the payment of almost $4 million in tax.[98] However, even if the appeal against the Commissioner's decision is successful, this case will not necessarily resolve the uncertainty in other class action settlements because the liability to pay tax may depend on the type of legal claims that are made in a class action and the structure and terms of the settlement distribution scheme.

7.16 In our view there is a strong policy basis for legislative reform which finally and definitively resolves this uncertainty for the benefit of class members. This could be done in a similar way to the exemption from payment of tax on interest on a judgment debt following an award of damages for personal injury under section 51-57 of the *Income Tax Assessment Act 1997* (Cth).

7.17 We would be pleased to elaborate on the issues raised above and to provide further information or materials in order to assist the ALRC's consideration of the issues.

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

7.18 We agree that:

(a) it is appropriate as outlined in Proposal 7-1 for the Class Action Practice Note (GPN-CA) to include a provision to the effect that a referee may be appointed by the Court in order to examine the reasonableness of costs in a class action;

[98] See the Applicant's Appeal Statement filed in proceeding VID 335 of 2018.

(b) an appropriate way to give effect to Proposal 7-1 is to establish a panel of competent and reputable independent costs consultants from which a referee may be selected;[99] and

(c) the appointment of a referee will not always be appropriate and should remain a matter of discretion for the docket judge.[100]

7.19 We also agree that it will be important to guard against unnecessary costs being incurred by the appointment of a referee *in addition* to an independent costs expert who is retained by the representative plaintiff. If the Court considers that it is appropriate to appoint a referee, we expect that in many instances the representative plaintiff would not additionally retain an independent costs expert. Bearing in mind that the review by an independent costs expert often takes several months and the expert is commonly engaged by the representative plaintiff soon after a provisional settlement is agreed, as a matter of practice it will be important for the Court to determine at the earliest possible time whether a Court appointed referee should be engaged.

7.20 We also make the general observation that if the Court establishes a panel of independent costs consultants that are considered to be competent and reputable, as a matter of practice we expect that many plaintiff law firms will engage one of those costs consultants as the independent costs expert even if the Court does not appoint a referee in an individual case.

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

7.21 In our submission:

(a) for the reasons discussed below, it is not appropriate that every settlement administration be the subject of a tender process;

(b) in some cases a tender might be appropriate – this should be evaluated on a case by case basis;

(c) in light of recent comments made by Murphy J in the course of deciding settlement approval applications,[101] it appears that the Court already has the power to require a tender process.

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99 Discussion Paper, [7.20].
100 Discussion Paper, [7.22].
101 *Money Max Pty Ltd v QBE Insurance Group Ltd* [2018] FCA 1030, [148]-[149]; *Caason Investment Pty Ltd v Cao (No 2)* [2018] FCA 527, [157]-[158].

Costs of settlement administrations

7.22 The underlying rationale for a tender process is that it would result in cost savings for the benefit of class members. It has been suggested that non-legal service providers, such as accounting firms, share registry services or claims administration services could undertake settlement administration work more cheaply and with the same level of competence as the representative plaintiff's solicitors, particularly in shareholder and investor claims.[102]

7.23 In our experience, the cost of settlement administrations is comparatively modest. The data available to us in relation to settlements administered by Maurice Blackburn is that the settlement administration costs are on average 3% of the settlement sum. This is across all types of class actions including several personal injury, property damage, cartel and other tort claims where administration costs are likely to be relatively high in comparison to the administration costs in shareholder and investors claims.[103]

7.24 In the major shareholder or investor class actions that we have conducted, settlement administration costs were on average even less: approximately 0.84% of the settlement sum, taking into account the aggregate settlement amounts of more than $1 billion and Court approved administration costs totalling around $8.5 million ($7.1 million for fees; $1.4 million for disbursements).

7.25 In view of the relatively modest costs of administering settlements, any tender process will need to be conducted in such a way that the process itself does not generate additional costs which offset the perceived benefit of carrying out the tender. These costs might include:

(a) the costs of the tender process itself;

(b) transaction costs of the "handover" to the successful tenderer of case related knowledge, class member data, files and records as well as class member relationships and contacts; and

(c) additional costs that might be incurred due to the fact that some work might have already been performed or partly performed by the representative plaintiff's lawyer before settlement approval, and the possibility that that work may need to be repeated or revisited by the successful tenderer in the context of their administration of the settlement.[104]

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[102] Discussion Paper, [7.29].

[103] Our submission does not specifically address the public commentary in *The Australian* newspaper regarding our conduct of the settlement administrations (and claims generally) in the Kilmore East and Murindindi bushfire class actions. Significant aspects of the reports in *The Australian* were factually wrong and in our view also tendentious. To the extent that other submissions to the ALRC invoke that commentary as the basis for reform in relation to settlement administrations and settlement distributions, we would be pleased to provide further information or a supplementary submission, although we also note that some aspects of those settlement administrations and the issue that arose were addressed in our submission to the VLRC in 2017.

[104] See for example *Money Max Pty Ltd v QBE Insurance Group Ltd* [2018] FCA 1030, [149(c)], where Murphy J noted that Maurice Blackburn had already undertaken a substantial amount of work in verifying trade data, some of which may need to be redone if another entity were appointed as the administrator of the settlement.

7.26 Although settlement administration processes involve relatively modest costs, there may nevertheless be merit in a tender process in an appropriate case, provided that the process itself does not generate unreasonable additional costs that are ultimately borne by class members. Any such additional costs would need to be offset by cost savings to class members as a result of the tender process.

Settlements of shareholder and investor claims

7.27 Settlement administrations, even in shareholder and investor claims, are not a straightforward, self-executing and mechanical process, at least until the stage when class members are ready to be paid. The Discussion Paper helpfully outlines some of the processes that are typically involved in the settlement administration for a shareholder or investor class action.[105]

7.28 It is easy to assume that some types of non-legal service providers will be able to carry out these functions and processes, however in our submission in a tender process it will be important for the tendering party to demonstrate that they in fact have the knowledge and capability to carry out the settlement administration competently. Our experience from the recent settlement of a shareholder class action is that competence should not be taken for granted. As is recognised in the Discussion Paper,[106] settlement administrations need to be carried out as cheaply and quickly as is reasonably practicable, however they also need to be done accurately. Any tender process will need to guard against the superficial allure of a cheap quote at the expense of genuine capability to perform the work.

7.29 Even if non-legal service providers are appointed to carry out certain functions in the administration of a shareholder or investor class action settlement, it is likely that they will in any event require legal supervision in that role, for example in order to:

(a) obtain guidance or advice as to applicable legal principles, including in relation to issues such as legal personality, succession of claims and other similar issues;

(b) engage other third party service providers or consultants, for example in relation to potential tax issues, and then act on the advice provided by those consultants and make decisions in the interests of the settlement administration;

(c) respond to unanticipated complications which might arise and which require legal work to be carried out; for example, formulating the response to an unexpectedly high participation rate of “Participating Unregistered Group Members” as occurred in *Blairgowrie Trading Ltd v Allco Finance Group Ltd (Receivers and Managers Appointed) (In Liquidation)* [2017] FCA 330, or dealing with late registrations by class members;

(d) report to the Court.

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[105] Discussion Paper, [7.29].
[106] Discussion Paper, [7.28].

7.30 In or submission it is difficult to conceive of non-legal service providers having sole responsibility for a settlement administration, although they could perform a confined role in managing class members' data, calculating entitlements by applying the loss assessment formula and then making payments to class members. To the extent that non-legal service providers might be able to perform these aspects of a settlement administration, the preferable way for this to occur is for the representative plaintiff's lawyer to engage the non-legal service provider in the same way that other experts or professional services providers are already routinely retained in relation to some aspects of a settlement administration; for example, the engagement of:

(a) loss adjusters in a property damage claim;

(b) experienced counsel to act as assessors in a personal injury claim;

(c) actuarial experts in order to provide advice on the management of a settlement fund, as has occurred in the DePuy ASR hip implants class action;[107]

(d) consultants with expertise in a variety of fields such as tax or auditing.

7.31 Engagement of non-legal providers could occur following a tender process carried out by the representative plaintiff's lawyer before seeking settlement approval, with the proposed engagement of the non-legal service provider forming part of the settlement approval application. If the plaintiff's lawyer ultimately proposes to carry out the specified areas of work themselves, they could be required to justify that decision by reference to their own projected costs in comparison with the costs quoted by the tendering parties.

Settlements other than shareholder and investor claims

7.32 We agree with the ALRC's observation that there are additional complexities in settlements of class actions involving personal injury, property damage or economic loss claims. One of the reasons for this is that, as was observed by Murphy J in *Caason v Cao*, the representative plaintiff's lawyer will "usually obtain a detailed and nuanced understanding of the different categories of claims and of complexities within each category of claim", and that fairness and efficiency of the settlement administration will be enhanced by such an understanding.[108] We also agree with Justice Murphy's observation that the representative's solicitors usually "earn the trust of the great majority of class members", which not only promotes efficiency in the settlement administration but is also important more broadly because the appointment of alternative administrators may cause distress to severely injured claimants who had developed rapport and trust with their lawyers over the course of several years.

7.33 Specifically in relation to the potential role of non-lawyers, settlements involving personal injury, property damage and other economic loss claims often involve the application of criteria to determine whether or not a class member is eligible to receive compensation pursuant to the settlement regime. It may be inappropriate for non-

[107] See clauses 10.4 and 10.6 of the settlement scheme in proceeding NSD 213 of 2011.
[108] *Caason Investment Pty Ltd v Cao (No 2)* [2018] FCA 527, [158].

lawyers to carry out this type of function, which involves legal decision making in the application of prescribed principles or criteria to the facts of individual cases.

7.34 In our submission a tender process will rarely be appropriate in class action settlements involving personal injury, property damage or economic loss claims, although we also note that only a very small number of plaintiff law firms have experience in administering settlement administrations after the resolution of mass tort claims, which are typically substantial and complex projects.

Conclusion

7.35 In our submission the Court already has the power to direct that a tender process be carried out in relation to some or all aspects of a settlement administration. Legislative reform is therefore unnecessary.

7.36 Although a tender process will not be warranted or appropriate in every class action settlement, in our submission amendments could be made to the Court's Class Actions Practice Note (GPN-CA) to the following effect:

(a) if it is in the interests of class members to do so, the Court may initiate a tender process in respect of the settlement administration process, with such a tender only being open to lawyers who are in a position to assume responsibility for the conduct and supervision of the entirety of the settlement administration;

(b) in order to carry out such a tender process, the Court may establish a panel of law firms that have experience in conducting settlement administrations and invite panelists to submit tenders in appropriate cases;

(c) the outcome of any such tender process would be decided by the judge hearing the settlement approval application, with the tendering parties able to appear and make submissions in respect of their tenders;

(d) paragraph 14.5 of the Class Actions Practice Note could be amended so that if there is no tender for the whole of the settlement administration, the Court will require evidence that the proposed manner of distribution of the settlement is efficient and cost-effective and that it will be done accurately, effectively and competently. This could be done by means of a "settlement distribution plan" that includes statements regarding the expertise and experience of the proposed settlement administrator and any third party service providers who are proposed to be engaged as well as the estimated costs of the administration;

(e) for the purpose of preparing a settlement distribution plan, the representative plaintiff's lawyer may be directed by the Court to carry out a tender process or otherwise investigate the efficacy and cost-effectiveness of engaging third party service providers in order to carry out specific aspects of the settlement administration, such as managing class members' data, calculating entitlements by applying the loss assessment formula and/or making payments to class members.

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

7.37 We agree that it will ordinarily be in the interests of justice for the terms of class action settlements to be made public.

7.38 We are not aware of many instances where the terms of a class action settlement have not been made public, and we consider that it will only be in rare and unusual cases where confidentiality of the settlement will be justifiable.

7.39 In making these comments we also note that settlement approval applications routinely involve confidentiality orders regarding some of the evidence that is filed; for example an opinion from counsel or the representative plaintiff's solicitors as to the prospects of success and the reasonableness of the settlement. For the avoidance of doubt, in saying that we agree that settlements should ordinarily be made public, the current practice regarding confidentiality of evidence should not be displaced and in our submission it would not be appropriate to do so.

8. REGULATORY REDRESS

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

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

8.1 We support the introduction of a collective redress scheme as an alternative means of ensuring that victims of corporate misconducted are compensated for their losses.

8.2 Recent experience with voluntary redress schemes indicates that, in appropriate circumstances, they can operate as effective and low cost methods of dealing with mass harm.

8.3 Any such scheme would need to preserve the entitlement of an individual claimant to vindicate their rights by means of conventional litigation (whether as a class action or otherwise).