AUSTRALIAN INSTITUTE
of COMPANY DIRECTORS

Level 30
20 Bond Street
Sydney NSW 2000
companydirectors.com.au
ABN 11 008 484 197

T: +61 2 8248 6600
F: +61 2 8248 6633
E: contact@companydirectors.com.au

19 May 2014

Access to Justice
Productivity Commission
GPO Box 1428
Canberra City ACT 2601

Email: access.justice@pc.gov.au

Dear Commissioners,

Draft Report Access to Justice Arrangements – Litigation Funding & Class Actions

The Australian Institute of Company Directors (Company Directors) welcomes the opportunity to provide comments in response to the Productivity Commission's draft Report *Access to Justice Arrangements* (Draft Report). We confine our comments in this submission to the matters raised by Chapter 18 of the Draft Report which relate to litigation funding and class actions.

The Australian Institute of Company Directors is one of the two largest member-based director associations worldwide, with over 34,000 individual members from a wide range of corporations; publicly-listed companies, private companies, not-for-profit organisations, charities and government and semi-government bodies. As the principal Australian professional body representing a diverse membership of directors, we offer world class education services and provide a broad-based director perspective to current director issues in the policy debate.

1. Summary

In summary, Company Directors comments are as follows:

(a) We continue to be concerned that the current regulatory regime supports litigation being initiated for the dominant purpose of profit-making by third parties that have no genuine interest in the issues being litigated;

(b) We have consistently stated that our preference is for litigation funders to be subject to a tailored licensing regime contained in the Corporations Act and enforceable by ASIC;

(c) We support recommendation 18.2 of the Draft Report which recommends that litigation funders be regulated by a licensing regime contained in the Corporations Act and enforceable by ASIC;

(d) We are concerned that the Productivity Commission is recommending the removal of the prohibition on lawyers charging contingency fees in Australia. We are concerned that allowing lawyers to charge contingency fees will undermine the well-respected integrity of the legal profession and the primary role of lawyers as officers of the court. The role of lawyers as officers of the court should be to quell, not promote, disputes. We recommend that the Productivity Commission re-consider recommendation 18.1 of the Draft Report.

2. Regulation of Litigation Funders

Company Directors has consistently raised concerns about major litigation against corporations being instigated, promoted and funded by professional litigation funders. We continue to be concerned about the practice of litigation being commenced for the dominant purpose of profit-making by third parties that have no genuine interest in the issues being litigated.

Company Directors considers that the fundamental objective of the court system is to facilitate justice and to resolve *real* disputes between aggrieved persons. We are of the view that a regulatory regime which encourages the proliferation of class actions for third party profit is not in the best interests of the Australian economy or community.

We have consistently recommended that third party litigation funders be regulated. We have also consistently stated that our preference is for litigation funders to be subject to a tailored licensing regime contained in the Corporations Act 2001 (C'th) which is capable of being enforced by the Australian Securities and Investments Commission (ASIC).[1] We note that recommendation 18.2 in the Productivity Commission's Draft Report is broadly consistent with our recommended approach. We therefore support the recommendation. We also agree with the Productivity Commission that the regulatory requirements for litigation funders are more appropriately set out in enforceable legislation and regulated under a licence than by an industry code.

Recommendation 18.2 of the Draft Report provides:

> *"Third party litigation funding companies should be required to hold a financial services licence, be subject to capital adequacy requirements and be required to meet appropriate ethical and professional standards. Their financial conduct should be regulated by the Australian Securities and Investment Commission (ASIC), while their ethical conduct should be overseen by courts.*
>
> *Treasury and ASIC should work to identify the appropriate licence (either an Australian financial services licence or a separate licence category under the Corporations Act) within six months of the acceptance of this recommendation by the Commonwealth Government after consultation with relevant stakeholders."*

We recommend that as a minimum the licensing regime proposed to be set out in the Corporations Act:

(i) provide certainty for participants in litigation that involves litigation funding;

(ii) protect potential members of a group intending to enter into a litigation funding arrangement and prescribe specific common safeguards and procedures;

(iii) prevent law firms from establishing related litigation funding providers;

(iv) require litigation funders to meet certain prudential requirements, including capital adequacy requirements, so that funders have sufficient assets to meet any relevant costs orders made against them or the members of the plaintiff group; and

[1] Submission to Federal Treasury dated 17 August 2011, Submission to Treasury dated 27 January 2012, Submission to Federal Treasury 7 November 2012, Submission to ASIC 13 March 2013, Submission to Productivity Commission dated 4 November 2013. All submissions are available at www.companydirectors.com.au.

(v) ensure that foreign litigation funders who finance actions in Australia have sufficient assets to satisfy costs orders and that those cost orders and the funding agreements entered into with persons located within Australia, can be enforced.

We note that Recommendation 18.2 in the Draft Report provides that the 'financial conduct' of litigation funders should be regulated by ASIC and the 'ethical conduct' of litigation funders should be overseen by courts. We note that the line between 'ethical conduct' and 'financial conduct' may be difficult to ascertain given that in many circumstances conduct will overlap. For example, the current Australian Financial Services Licence (AFSL) regime requires license holders to do all things necessary to ensure that the financial services covered by the licence are provided efficiently, fairly and honestly.[2] It is arguable that this provision regulates ethical conduct rather than financial conduct although it is central to the AFSL regime in the Corporations Act.

We are of the view that the licensing regime for litigation funders should be tailored, comprehensive and, as far as possible, should regulate financial and ethical conduct in one place, being the Corporations Act. Under such a regime courts and judges would retain their broad powers to oversee and manage the conduct of parties involved in litigation before them.

The Draft Report states that opponents to litigation funding are concerned that funded class actions lead to a rise in unmeritorious litigation but that there was no evidence presented to the Commission to suggest that this is the case.[3] In this regard it is appropriate to re-iterate to the Commission that Courts are reluctant to make summary judgments in complex matters and that the majority of class actions against corporations settle. For example, despite the number of shareholder class actions initiated against corporations, we are not aware of one action in Australia that has proceeded to a court judgment.

As stated in our previous submission, the commercial reality is that directors may feel that it is prudent to settle this type of litigation because it distracts the board and employees from focusing on core business activities. The cost and time involved in defending these actions is extensive and there are still many unsettled areas of Australian class action law, particularly in relation to actions commenced by shareholders, which adds to the level of uncertainty for companies.[4] The commencement of a large scale shareholder class action can itself place pressure on the target entity's share price. These factors, which provide incentives to settle even when the claim is less than meritorious, are well known to litigation funders and plaintiff law firms and may provide opportunities for actions to be initiated in order to extract a settlement amount. In this environment the merit of the case may never actually be examined by a Court.

In addition to our concerns that funded class actions have the potential to lead to unmeritorious litigation, we are also concerned that market based shareholder class actions may not be an effective mechanism for providing access to justice for aggrieved shareholders. This is due to the lack of available data which documents the *actual* returns to shareholders in these matters.

The Draft Report provides that:

> "While the funders' fees may seem like a large proportion of the amount recovered some, such as Attrill (2012), contend that given the costs, risks, time to resolve and

---

[2] Section 912A(1)(a) of the Corporations Act 2001 (C'th)

[3] Draft Report, Chapter 18.2 at page 536

[4] See for example, Grave, Watterson & Mould *Causation, Loss and Damage: Challenges for the New Shareholder Class Action* (2009) 27 C&SLJ 483

> the potential for adverse costs orders, the returns to funders do not appear to be excessively high. As opposed to lawyers in a conditional or damages-based fee agreement, the funder often covers all of the costs of litigation (including disbursements) and provides indemnity for adverse costs."

Unfortunately, the Draft Report does not explain that if a funded class action is successful, funding agreements will generally allow the litigation funder to draw down on the damages awarded or the settlement sum agreed, to recover the legal fees and disbursements the funder has paid during the course of the matter. *In addition*, the litigation funder will receive 25-35% (or more) of the remaining damages or settlement sum. The returns available to group members will be further eroded by the fees paid, usually to lawyers, if any scheme is set up to administer and facilitate the returns to group members. It is only then that the residual amount (if any) will be paid to group members.

In an insolvency context, Justice Palmer in *Hall v Poolman* stated:

> "When the trial commenced, the Court was informed that, even if the Liquidators recovered the full amount of their claims, including costs and interest, after Liquidators and their solicitors, unsecured creditors would receive no more than a fraction of a cent in the dollar of their claims. I expressed concern that such huge costs could be incurred in prosecuting claims by liquidators when virtually every cent of the proceeds of the claims even if wholly successful, would go to a litigation funder and to the costs and disbursements of the professionals engaged in conducting the litigation...*If 'access to justice' for the creditors were the justification for these proceedings, that justification fails when creditors will be lucky to get anything at all...* on the other hand, IMF will, if successful, profit to the tune of millions of dollars."[5] [emphasis added]

Until further data is made available and is properly analysed to determine the actual returns paid to shareholders (after legal fees, disbursements, funder's fees and fees paid to administer returns to shareholders) Company Directors' continues to question whether funded shareholder class actions actually deliver access to justice.

Despite these observations as to the content of the Draft Report, we strongly support the Productivity Commission's recommendation that litigation funders be regulated. If this recommendation is adopted by the Government we are of the view that it would be a positive step forward toward addressing a problem which has been a concern to the business community for some time.

3. Contingency Fees

Recommendation 18.1 of the Draft Report provides:

> *"Australian governments should remove restrictions on damages-based billing subject to comprehensive disclosure requirements. The restrictions should be removed for most civil matters, with the prohibition on damages-based billing to remain for criminal and family matters, in line with restrictions for conditional billing."*

Australian companies, directors, and the community benefit from a professional and impartial legal system where first and foremost lawyers are officers of the Court. We are concerned that allowing lawyers to charge contingency fees (damages-based billing) will

[5] *Hall v Poolman* (2007) 215 FLR 243 at 250 and 332.

undermine the well-respected integrity of the legal profession and will have the potential to create conflicts of interest between lawyers and clients.

In this respect we share the views of Justice Keane[6] writing extra-curially who stated:

> "What is far from clear is that the public interest is advanced by the unregulated commodification of the role of the courts. The stakes include the integrity of the role of the courts and their officers as an arm of government whose concern is the quelling, not the promotion, of disputes."

We are also concerned that removing the prohibition on lawyers charging contingency fees may:

(i) further increase the volume of litigation, including class actions, initiated against corporations;

(ii) cause insurance premiums payable by corporations and directors to increase;

(iii) place increased cost pressures on corporations to defend litigation, funds which could otherwise be directed to employing staff, investing in infrastructure and providing returns to investors;

(iv) create an increasingly litigious corporate environment which provides a further disincentive for good directors to serve on boards; and

(v) cause many of the benefits in regulating litigation funders to be undermined.

We are of the view that the increase in funded shareholder class actions is creating an environment where some lawyers are acting primarily as entrepreneurs and promoters of litigation. This may occur, for example, where a lawyer scans the ASX announcements platform for a corporate profit downgrade announcement and a subsequent share price fall, prepares a claim and then actively seeks out a plaintiff and group members who may wish to be involved in a class action against the corporation. We are concerned that the promotion of litigation in this manner undermines the fundamental role of lawyers as officers of the Court. We expect that the trend of lawyers acting as entrepreneurs and promoters of litigation will increase if the prohibition on lawyers charging contingency fees is lifted. In these circumstances policy settings may need to consider whether it is appropriate for courts to direct costs orders to those acting primarily as entrepreneurs in these actions rather than as just lawyers.

We request that the Productivity Commission seriously re-consider Recommendation 18.1 in light of its potential to encourage speculative litigation against corporations. We are concerned that if Recommendation 18.1 is adopted it will negatively impact upon productivity, job creation and the professional standards and standing of lawyers.

We hope that our comments will be of assistance. If you would like to discuss any of our views please contact me or Senior Policy Advisor Leah Watterson on (02) 8248 6600.

Yours sincerely

John H C Colvin
Chief Executive Officer &
Managing Director

---

[6] P.A. Keane, *Access to Justice and other shibboleths*, paper presented at JCA Colloquim on 10 October 2009 available at http://jca.asn.au/wp-content/uploads/2013/11/2009AccesstoJustice.pdf