

20 May 2014

Productivity Commission  
Level 12, 530 Collins Street  
Melbourne VIC 3000

Dear Commissioners

### *Access to Justice Arrangements, Draft Report*

Governance Institute of Australia (formerly Chartered Secretaries Australia) is the only independent professional association with a sole focus on the practice of governance. We provide the best education and support for practising chartered secretaries, governance advisers and risk managers to drive responsible performance in their organisations.

Our Members are all involved in governance, corporate administration, risk management and compliance with the Corporations Act 2001 (the Act) with their primary responsibility being the development and implementation of governance and risk management frameworks in public listed and public unlisted companies, private companies, and not-for-profit organisations.

We welcome the opportunity to comment on the *Access to Justice Arrangements: Draft Report*, noting that we provide feedback on one aspect of the report only. Our feedback relates to Draft Recommendation 18.2 on page 546 relating to the regulation of third party litigation funders.

While Governance Institute strongly supports consumers being able to access the courts readily, we are equally strongly of the view that promoters of funded class actions should not be unregulated. Currently the majority of litigation funders are not licensed, nor are the law firms which act as promoters, yet funded class actions are an accepted mechanism in the framework of those seeking restitution from corporations. Other such mechanisms are regulated.

This is not simply a matter of disclosure, but of an unregulated industry where the interests of only some parties in the litigation are currently being protected, and where the desire to ensure that ordinary people retain access to the courts has obscured conflicts of interest that need to be addressed in any allocation of financial risk. We think that this is particularly inappropriate, given that the litigation is an especially complex and risky investment and the investors who participate in class actions need to be informed and protected. It is for these reasons that Governance Institute is of the view that regulation of class action promoters is required.

We have been on the public record for some years as recommending that:

- the litigation funder/promoter is financially sound and subject to prudential regulation
- the conduct of a promoter in promoting funded class action litigation should be regulated and subject to regulatory oversight
- positive disclosure obligations should be imposed on promoters in relation to litigation funding arrangements and this should be subject to regulatory oversight
- promoters should have a specific obligation in relation to the management of conflicts of interest and this should be subject to regulatory oversight.

Our recommendations seek to implement a regulatory framework that can ensure that the interests of all parties involved are protected. We recommend that disclosure should be required to the investors participating in the class action regarding the arrangements, so that all participants are informed, and there should also be an obligation to report any material or systemic breaches of the arrangements. We also recommend that there should be a requirement that the funder is obliged to lodge with ASIC a confirmation that they have all those arrangements in place (both on an initial and ongoing basis), so that the regulator can assess the ongoing adequacy of the arrangements.

Our recommendations have stemmed from concerns that:

- while the funder promises to meet all adverse cost orders which may be made in favour of the defendant, if the funder lacks adequate capital or insurance to meet those costs, the representative member of the class may have an exposure to costs. Funders may manage this by selecting an impecunious representative, knowing the courts are unlikely to grant security for costs. There is a clear incentive for class action promoters to commence actions regardless of whether their risk assessment is that the prospects for success are unlikely and regardless of whether the litigation funder has capital adequacy to meet costs should the action fail
- given that defendants are forced to incur costs, as there is no guarantee of being able to recover costs even if successful, and those costs can be very significant, the current situation is conducive to initiating unmeritorious class actions in the hope of forcing a settlement (so-called 'blackmail suits'). The significant costs are, of course, ultimately borne by shareholders (for example, management's time is diverted from the business to defending the litigation; legal advice is costly; media scrutiny of the proceedings can have an adverse effect on the share price and reputation of the company)
- representations made by promoters and law firms, including in the period before proceedings are initiated (and therefore not subject to court supervision) in promoting the litigation may be misleading or deceptive, both in terms of their effect on the members of the class and the proposed defendant and its business
- there is no doubt that a conflict of interest situation exists in funded litigation — the promoter and/or law firm actively seeks out and creates an action to further its business, not the interests of the plaintiffs (although these may be incidentally served). Without adequate conflicts management arrangements, litigation funders whose interests conflict with those of their clients are more likely to take advantage of those clients in a way that may harm the clients.<sup>1</sup>

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<sup>1</sup> IMF (Australia) Ltd, 'Policy Issues in Litigation Funding', Supreme and Federal Court Judges Conference, Hobart, January 2009 explain the type of conflicts of interest that may arise in the case of a funded class action as follows: 'Conflicts of interest may arise between the funder and the funded litigant which may lead to the litigant's legitimate interest being subordinated to those of the funder or being ignored altogether (for example the funder forces an early and cheap settlement on the litigant in order to improve the funder's cash flow or the litigant refuses to accept a reasonable settlement offer when the funder believes that it would be prudent to do so)....The tripartite relationship between funder, client and lawyer has the potential to create numerous conflicts. This may be of particular significance in multi-party proceedings, where claimants could be more vulnerable to both the funder taking control of the proceedings and to lawyers who fail to sufficiently protect and promote the claimants' interests above their own. This includes the lawyer giving advice on the benefits and risks of the funding proposal — which might be seen to be an ethically perilous undertaking if the lawyer is financially dependent on the funder for the litigation to proceed. Further, not only does the lawyer face potential conflicts between the funder's and the client's' interests, there is also a potential conflict between duties owed to different clients if the lawyer is retained by the funder and not directly by the litigants.

We recognise, as stated at page 545 in the Draft Report that ‘Litigation funders are already regulated by courts to some extent.... courts have previously ordered funding agreements to be rewritten to facilitate informed consent’.

However, we note that the Draft Report also states that ‘this is predicated on courts being aware that a funder is involved in a case, and has jurisdiction over the funder’.

**Governance Institute therefore strongly supports Draft Recommendation 18.2:**

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 the 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.

Governance Institute notes that, currently, the interests of only some parties in the litigation are being protected, and that regulation would ensure that investors are protected by being adequately informed. The recommendation set out in the Draft Report would result in such protection.

Yours sincerely

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Chief Executive