CHARTERED SECRETARIES
AUSTRALIA

Leaders in governance

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The Manager
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Corporations and Capital Markets Division
The Treasury
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Dear Treasury

Exposure Draft: Corporations Amendment Regulations 2011 (No.) — Funded Class Actions

Chartered Secretaries Australia (CSA) is the independent leader in governance and risk management. As the peak professional body delivering accredited education and the most practical and authoritative training and information in the field, we are focused on improving organisational performance and transparency.

Our Members are all involved in governance, corporate administration and compliance with the Corporations Act (the Act), with primary responsibility to develop and implement governance frameworks in public listed and public unlisted companies, as well as in private companies.

CSA welcomes the opportunity to comment on the Exposure Draft: Corporations Amendment Regulations 2011 (No.) – Funded Class Actions.

CSA notes that the proposed reforms are intended to ensure that:

- class actions are not subject to the definition of a managed investment scheme (MIS) or the regulatory requirements applying to MIS in the Corporations Act (the Act)
- litigation funding schemes are not financial products as defined in Chapter 7 of the Act
- a range of registration, licensing, conduct, disclosure and other requirements are not imposed on litigation funders and their arrangements with their clients.

The government has announced its aim is to support class actions and litigation funders by ensuring they provide access to justice for a large number of consumers who would otherwise have difficulties in having their claims heard and assessed.

While CSA supports consumers being able to access the courts readily, CSA is 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 who act as promoters, yet funded class actions are an accepted mechanism in the framework of those seeking retribution from corporations. Other such mechanisms are regulated.

CSA Members note 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.[1]

CSA notes that the interests of only some parties in the litigation are currently being protected, and that regulation would ensure that all parties are protected. The proposed amendments would also result in less protection for investors. We think that this is particularly inappropriate given that the litigation is an especially complex and risky investment. It is for these reasons that CSA is of the view that regulation of class action promoters is required.

[1] 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.

CSA recommends 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.

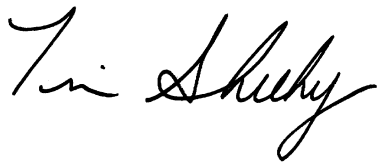
CSA notes that the current proposal is to reverse the effect of the Federal Court decision *Brookfield Multiplex Limited v International Litigation Funding Partners Pte Ltd* [2009] FCAFC 147 by making regulations clarifying that funded class actions, as well as similar arrangements, are not MIS.

CSA notes that regulation of promoters of class actions need not be through the application of the MIS legislation but could be achieved through other mechanisms. CSA is not recommending that the only means of regulating promoters of class actions should be through the MIS legislation, but is strongly recommending that a regulatory framework needs to be applied in order to ensure that the interests of all parties involved are protected.

CSA recommends that disclosure should be required to the individuals 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. 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.

CSA would be more than happy to discuss this issue further with you.

Yours sincerely



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