

11 June 2020 – Via Email

Parliamentary Joint Committee on Corporations and Financial Services

Dear Committee,

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

We are three practicing dentists that have agreed to be lead plaintiffs in a class action process relating to Smiles Inclusive (ASX: SIL). **See appendix A.**

This submission reflects our own real-life experiences to date including insights into the broader regulatory environment within which Class Actions operate.

We make ourselves available to attend as witness to the Parliamentary hearings in July and for this submission to be published.

1 Summary

While we are very new to the world of class actions and litigation funding, our observations, based on deep personal immersion since June 2019, are as follows:

- **A binary dynamic** – A class action provides a pathway that simply would not otherwise be available to us. ‘Us’ includes 300 staff, 100 fellow dentists, 1,400 Smiles shareholders and many unsecured SME creditors. Each person’s individual claim is simply too small relative to the legal costs involved. We are a classic Class Action case / example.
- **Complements existing regulatory mechanisms** – A private sector class action fills the gap / void in between:
 - The ‘light touch’ of the ASX that in reality, while it may be nimble to move, has limited powers to prevent reoffending real time and thus prevent serious harm (**prevention is better than cure**)
 - In contrast, ASIC has significant powers but is hampered by high thresholds to act which is compounded by resource constraints resulting in uncommercial timeframes for taking relevant preventive action (**too little, too late**).

Both ASX and ASIC, for different reasons, do not serve as adequate commercial deterrents. If they did, class actions would not exist. To date, our conclusion is that on a risk adjusted basis, currently white-collar ‘non-compliance’ pays. Class actions are a direct response and mirror to this reality.

In summary, class actions have the potential to both serve as a meaningful deterrent (relative to ASX) and an equitable / pragmatic remedy where an offence has already occurred (relative to ASIC).

- **Don't shoot the messenger** – We are somewhat surprised at the rhetoric we have read to date in the business media regarding the origins of this inquiry and the apparent 'demonising' of class actions and litigation funding.

Based on our own first-hand experiences, we sense Class Actions represent only the tip of an iceberg of systemic failures in Australian corporate governance. The Hayne Royal Commission into the banking sector is not an outlier, it just happens to be a business sector of high public and political interest.

As ever, most serious issues start at the top. We note that 'big business' seeks to reign in class actions – we are not surprised. We are disappointed.

Class actions as an industry would not exist as a sustainable business model were it not for the original offending. We encourage greater emphasis on better prevention (more meaningful enforcement) rather than focusing critically on an industry that we believe is very necessary. We speak from real-life experience. We have no other avenue available to us.

As we embark on our own journey, we are encouraged by the words of Justice Lee last week regarding the PFAS Class Action that was recently settled:

"This was on any view of it, a very big case. A case that had real complexity and a case where there was real risk, it could not.... I think it's fair to say not be brought without a funder.

There is a good deal of cynicism about the legal system in general and about class actions in particular, but to my mind, the present case [PFAS Class Action] is a good example of the system working and working well" **Justice Lee**
June 9, Lawyerly

2 Background

Smiles Inclusive is a publicly listed healthcare group listed on the ASX under the code 'SIL'.

Smiles IPO at \$1 a share in late April 2018. Within 8 months of listing Smiles shares fell to 10 cents a share. **A fall of 90%.** The shares last traded hands off-exchange at **1.1 cent a share** (last month). **See appendix B.**

Smiles shares have been suspended since **2 March 2020** due to its failure to file its KPMG audited accounts. **See appendix C.** Smiles has been insolvent since 2019, well before COVID-19. Still, Smiles receives JobKeeper payments of \$1m a month.

Until recently we were contracted dentists to Smiles. We resigned on 17 April 2020. We remain JVP partners, shareholders and overdue outstanding creditors.

Since April 2019 we have sent approximately 50 submissions to ASX and ASIC totalling circa 1,500 pages of evidence. In addition, other parties have also stepped forward as definitive whistleblowers.

ASX has issued seven 'please explains' to Smiles, six since September 2019. We remain in ongoing dialogue with ASIC.

3 Specific Responses To The Terms Of Reference

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

- A better way to frame the discussion is what would plaintiffs receive if litigation funding were not available? The ‘counterfactual’. In our case, nothing.
- Class actions are often settled with 18 months of commencing – 90% never go to court – settled on the steps of the court. This includes, for example the ‘Robodebt’ case. That so many cases settle out of court so close to trial also suggests Class Action cases have merit. If not, defendants would go to trial.
- Class actions may ensure less subsequent reoffending once the class action case has been initiated. In lay terms, class actions help to ‘keep the buggers honest’. A speedy deterrent to reoffending. We must confess that is not the case regarding Smiles. However, Smiles is an extreme case. We are mindful of:
 - **Sterling First Group** – Issues first raised with ASIC in early 2017.
 - **Smiles Inclusive** – First complaint to ASIC lodged in April 2019
 - **Blue Sky** – ASIC’s “nothing to see” vs 3 law firms vying to lead the class action

Note there are strong and numerous personnel overlaps between Smiles Inclusive and Blue Sky Alternative Investments.

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

- We believe a natural alignment between performance and reward is inherently a positive set-up. It is no different to every other profession and business sector. In contrast, 100% of nothing is nothing.
- Private sector performance / efficiency is based on the fundamental premise that superior performance is rewarded accordingly.
- Contingency fees make the law more accessible to smaller plaintiffs. Commercial democracy via a ‘free vote’. In contrast, a defendant’s superior balance sheet is the thing that big businesses often hide behind and thus enables poor governance to continue. We are three practicing dentists currently taking on a publicly listed (insolvent) company.
- Whatever the glitches to be ironed out, the wording of the term of reference is itself is unduly negative. We encourage a more balanced mindset.

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

- There will always be tension. It is no different to the dynamics of a marital divorce. Whether to keep going, ask for a greater share of the spoils but incur more legal fees.
- Ultimately, market forces / competition in combination with appropriate regulation will keep parties honest – because unhappy clients talk with many people!

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

- Everybody needs a boss. The Class Action / Litigation Funding sector is no different. Just because to date there has been limited oversight of the sector does not mean the sector is inherently bad. One argument is that if there were fundamental flaws / issues then regulation would have occurred much sooner.
- The issue is possibly who should monitor the Class Action / Litigation Funding sector?
- Our experience thus far is that the ASX and ASIC, just like a police force, are not immune to shortcomings in performance. It would seem odd therefore that Class Action / Litigation Funders could find themselves suing a regulator for non-performance, yet also find themselves policed by the defendant aided by significant laws (civil and criminal).

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

- We thoroughly endorse this approach. A single case – awarded to the best prepared case – incentivises plaintiff's respective parties to move at speed and compile high quality cases – a form of healthy competition. Such competition ultimately strengthens the chances of all members to a class action benefiting from a more winnable case.

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

- Is that factually true? Our research suggests that over the last three years there has been a steady number of cases with a diminishing share funded by litigation funders
- To put class actions into perspective, there are circa 60 cases a year across the entire economy worth two trillion dollars – compare this with the number of regular commercial legal cases a year.
- Others factors to possibly consider include:
 - Regulatory effectiveness - ASIC had suffered from significant budget cuts in the past – *'while the cat's away the mice will play'*
 - Education / awareness – Democratisation of information courtesy of the internet – people know their rights more and how to go about enforcing them
 - Hayne Royal Commission – this alone has promoted a greater sense of a consumer's rights

9. what evidence is becoming available with respect to the present and potential future impact of class actions on the Australian economy;

- With respect the question feels 'loaded' – anything that keeps companies more 'honest' is a good thing. And not funded by the tax payer!
- Class action / Litigation funding is a niche, ala Private Equity another much maligned, misunderstood sector. While class actions capture the headlines, just like PE, class actions keep firms honest. If firms were well run there would be no opportunity for PE. Likewise, if a defendant firm's corporate governance was effective opportunities for class actions would not exist.
- Litigation funding models are based on the same PE financial model – risk / reward, clear business case. Multiple studies have shown the PE sector creates economic benefit for the economy as a whole. We suggest that the same motivator, 'profit' leads to effective / efficient access to the law and in turn **leads to better corporate governance.**

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

- Contingency fees – Estate agents have operated this way since day one. Note the single biggest source of personal wealth in Australia is property, 60% of personal wealth.
- Therefore, why not Australian lawyers?
- In a commercial setting, any arrangement that involves mutual risk taking is more likely to lead to suitable behaviours and equitable outcomes. Bigger issues arise when there is not alignment, it is the single biggest complaint with the law sector today. The client carries all the risk. This is the challenge we face regarding Smiles. Each violation requires a fresh statement of claim.

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

- The question feels somewhat a red-herring - Litigation funders will not take on a case unless there is 1 - Clear defendant managerial specific culpability and 2 - Where there are recoverable funds available. The vast majority of funds paid out come from a defendant's insurers.

General macro factors outside the control of management are not the basis for a class action case.

Like PE, litigation funders are disciplined investors. They are, after all, the ones taking the biggest risk. They, more than anybody, have good reason to exercise caution as to which cases to pursue. They choose their battles wisely - based on hard evidence.

- Moratorium on insolvency – As cited by insolvency practitioners and the Australian Turnaround Association, there is a real risk some companies will seek to take advantage of the current relief measures. Including a softening of continuous disclosure obligations. Class actions actually provide a counter to extreme opportunistic behaviours that look to gain from the current relaxation in regulations. Paradoxically, class actions are required more than ever to weed out in 'real time' the opportunist behaviours.

4 In Closing

Undoubtedly our perspective is coloured by our first-hand experience with Smiles. We have developed deep 'layman' insight and the matters are fresh. Given all the Government's relief measures, based on our experience with Smiles, an insolvent company before COVID-19 and now claiming \$1m a month in JobKeeper, the pendulum is swinging too far. At a time when ASIC has bandwidth issues due to the consequences of the Hayne Royal Commission, class actions are more important than ever. In closing we are reminded of a simple principle:

"Truth is the best friend of the innocent"

We make ourselves available for the Parliamentary hearings in July.

Yours sincerely

Dr Makepeace

Dr Camacho

Dr Walsh

Holding Redlich to lead class action against Smiles Inclusive



Written on the 9 October 2019 by Matt Ogg

Law firm Holding Redlich has confirmed the process is underway for a class action against embattled Gold Coast-based dental group Smiles Inclusive (ASX: SIL).

The company has seen profits, cash and its share price deteriorate since its April 2018 initial public offering (IPO) that raised \$35 million to support an ambitious national acquisition plan.

Smiles' expansion included joint venture partnerships (JVPs) with dentists around the country, but its guidance to the market and results worsened over time.

From a listing price of \$1 the company's share price has dwindled to 4.6 cents at the time of writing, as Smiles undertakes a capital raising to stay afloat and pay a small fraction of the \$19 million it owes to National Australia Bank (ASX: NAB).

The capital raising was announced prior to a substantial adjustment to Smiles' FY19 loss from \$19 million in the unaudited results to [\\$31 million in the statutory figures](#).

Two JVP dentists who have been vocal about governance issues at the group are Dr John Camacho and Dr Arthur Walsh, who are now taking their battle against the corporate up a notch.

"Holding Redlich Melbourne have stepped forward ready to lead the \$50 million class action process," Camacho said in a press release this morning.

"Regardless if Smiles goes into administration, we are committed to recouping cash from Morgans, KPMG, Talbot Sayer and Smiles Directors and Officers personally.

"The class action, aimed at recouping 95 cents a share, offers a lot more upside for shareholders than the current 4 to 5 cents on offer."

[ASX grills Smiles Inclusive over KPMG audit](#)

Holding Redlich confirmed with *Business News Australia* that the action was on the cards.

"Holding Redlich have agreed to lead a class action process working closely with aggrieved dentists and shareholders. The IPO is the starting point," a spokesperson for the firm said.

In an announcement to the ASX yesterday evening, Smiles said it had become aware that some parties were "sending misleading and deceptive information to shareholders and issuing media releases which deliberately misrepresent matters relating to the Company and its operations".

"All interested parties should treat these statements with extreme caution," the company said.

"The motivation of these parties is unknown at this time, but all indications are is that their intention is to see the company fail.

"The Company's recently announced rights issue is fully underwritten and will provide the Company with the opportunity to execute its turnaround plan."

At the time of writing, Smiles had not responded to requests for comment about which specific information it believed was "misleading and deceptive".

THE AUSTRALIAN

Shareholders grin and bear it at troubled Smiles

By **JARED LYNCH**, REPORTER

12:00AM JUNE 2, 2020

Embattled listed dental group Smiles Inclusive has amended its latest cashflow statement after botching its previous effort lodged with the ASX, and has revealed its directors paid themselves \$32,000 for the quarter.

Smiles — which has been suspended from trading since late February after it missed the deadline to file its audited accounts — has been forced to amend all the main lines of its quarterly cashflow statement, revealing it had a little over half the net cash available as previously stated.

As of the three months ending March 31, Smiles had \$145,000 in cash, compared with \$242,000 as previously stated. Meanwhile, it used \$614,000 cash in operating activities versus \$500,000 net cash from operating activities as previously reported - a turnaround of \$1.1m.

“Furthermore, and in addition to the business update commentary that was provided on 30 April 2020, the company notes the payments of \$32,000 to related parties ... are in relation to salary and fees paid to directors of the company for the quarter,” Smiles said in its revised cashflow statement.

It is the latest misstep in a long-running saga, which has involved delayed payments to suppliers as far back as 18 months ago, breached covenants, and dentists locked out of their practices, while earlier this year Smiles stopped paying rent and staff wages until it secured a bridging loan from NAB to access the Morrison government’s \$130bn JobKeeper scheme.

Founding chief executive Mike Timoney has sold his entire 6.7 per cent stake in the company and told The Australian his final moments at Smiles was like being “a passenger in a car crash”.

Mr Timoney, who was ousted from the company at a shareholder meeting in May last year, sold his 9.659 million shares at 1.1c apiece, netting \$106,249, less than a third of their last trading value.

It is a paltry sum compared to what he could have walked away with when he left Smiles, with his then 17 per cent holding worth about \$3m before it was diluted in a series of capital raisings to repair the company's balance sheet and its share price crashed to 3.5c. "I said at the time I felt like a passenger in a car crash," Mr Timoney said. "If I could have walked out then and sold my shareholding I would have, but I was escrowed."

"It's a tragedy. They were 30c at the time, my shareholding was worth \$3m, I had been compulsory escrowed and I sold them 13 months later for \$106,000. And exactly what I said would happen did happen."

The ASX has issued six queries since March last year about the company's financial health and concerns about its continuous disclosure obligations.

A total of 10 dentists also terminated their service agreements with Smiles in April on insolvency grounds. They have since been locked out of their practices, which they sold to Smiles and reinvested 40 per cent of the sale proceeds back into the company in a profit-sharing agreement.

Investors and analysts, meanwhile, are finding gauging the financial health of the company difficult, given Smiles has yet to receive final sign-off for its half-year accounts from its auditor.

Mr Timoney says the company's problems began long before the coronavirus pandemic.

"The company was stuffed before COVID-19. How could it possibly recover when it couldn't pay its bills prior to COVID-19 and now COVID-19 is going to put the healthiest companies on the rack, let alone ones in health care where it's going to be difficult to circumnavigate new procedures.

"We are talking about virtual waiting rooms in car parks, calling in patients. They are talking about negative air pressure in dental surgeries. None of this is going to make the industry more efficient or profitable."

He said Smiles' troubles began within the first three months of its float when it had three deaths, including a senior orthodontist. He said the troubles compounded when the school dental van business it acquired was found to be illegally X-raying children.

The company says it is in advanced negotiations of recapitalising its balance sheet.

Jared Lynch is a business reporter with a career spanning 15 years across national publications. Jared is based in Melbourne and writes on agribusiness, healthcare and gaming. He also has extensive experience i... [Read more](#)

BUSINESS

Burleigh-based Smiles Inclusive suspended from ASX after failing to lodge half-year results

A major blow has been struck against Gold Coast dental practice group Smiles Inclusive this morning.

Alister Thomson, Business Editor, Gold Coast Bulletin

 Subscriber only | March 2, 2020 10:03am

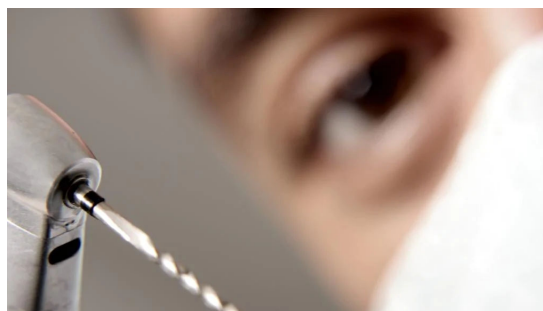
BURLEIGH-based dental practice group [Smiles Inclusive](#) has been suspended from the ASX after failing to lodge its half-yearly accounts on Friday.


The [Tony McCormack-led company](#) made the announcement this morning stating it understood the ASX will suspend its shares from this morning until it releases its half-year financial statements.

“The company’s audit and risk committee and management team are working closely with the company’s auditor to release the finalised results as soon as possible,” it said.

Smiles shares last traded at 3.5c and have fallen as low as 3.1c in the past 12 months.

The company has faced two grillings recently from the ASX in regards to whether it is complying with the sharemarket operator’s listing rules.



 Shares in Smiles Inclusive were suspended this morning. Photo: iStock

Smiles responded on February 24 to queries from the ASX relating to compliance with its finance facility with main lender NAB.

The company said it had been granted a waiver for the covenants for the NAB loan in March subject in part to ongoing review and reporting by accountancy

Smiles said it was currently in discussions with NAB on the development of modified covenants.

The company was also questioned by the ASX in early February regarding its latest negative cashflow report which left a negative balance of \$3.2 million.

Chairman David Usasz responded then that the company was continuing with its turnaround plan.

“Results remain positive despite the cashflows for the last quarter which were negatively affected by the typical end-of-year seasonal slowdown, an additional pay cycle for the month of December and several one-off legal, insurance and business restructure costs,” Mr Usasz wrote.

He said the company expected cashflow to improve in the short-to-medium term although “the likelihood of negative operating cashflows for the time being remains relatively high”.