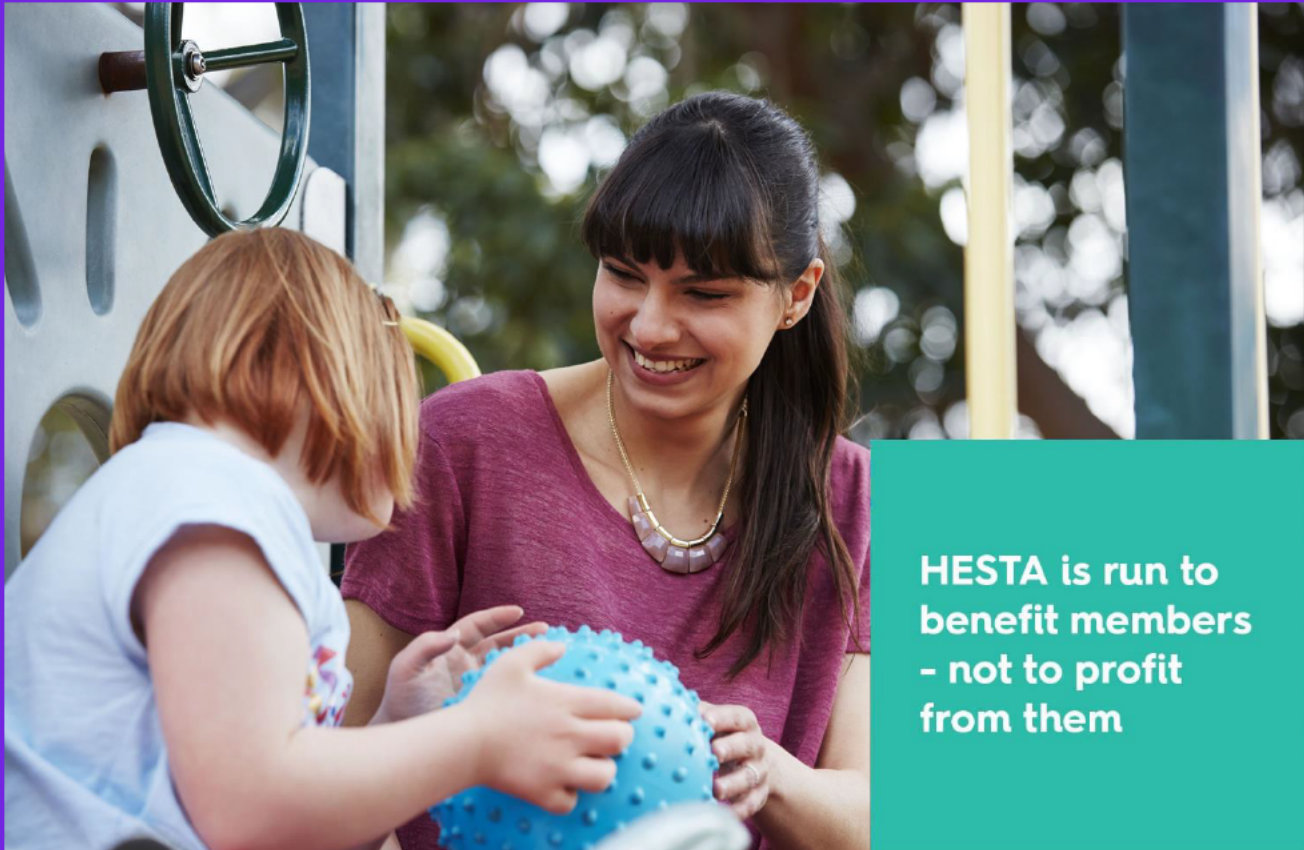


| HESTA |



**HESTA is run to  
benefit members  
- not to profit  
from them**



**HESTA is the only fund  
dedicated to health and  
community services**

**HESTA Submission –  
Litigation funding & regulation of the class action industry.  
June 2020**



## Litigation funding and the regulation of the class action industry

### Summary

HESTA welcomes the opportunity to make a short submission to the *Litigation funding and the regulation of the class action industry inquiry*. We have primarily focused on the important discussion of shareholder rights and ensuring a balance of power between shareholders as the owners of the company and management.

HESTA is pleased to see the Australian Law Reform Commission (ALRC) and the Federal Government focusing on an important area of corporate democracy, and we encourage any reform to be conducted from the position of advancing the health of corporate governance which relies on the good functioning of shareholder rights. We have previously made a submission to the ALRC discussion paper and note the Government is yet to provide a response to this important report, we recommend a response be prioritized.

HESTA is an industry fund with a strict profit-to-members model that was created to meet the specific needs of employees working in the health and community services sector. HESTA manages \$50 billion of assets for 860,000 members who are mostly women (80%), are likely to take career breaks, to live longer, and more likely to be dependent on the Age Pension in retirement. Our members have given their lives in paid and unpaid caring roles and the dignity they deserve in retirement can be significantly errored through poor corporate behavior of management in companies they own through their super fund.

HESTA participates in class actions to recover losses but also as a means of encouraging better standards of corporate governance and improved accountability by companies, directors and corporate advisors to their shareholders. We see legal action as a vital third arm of active ownership that compliments engagement and share voting to achieve long-term change for benefit of members.

Curtailing the ability of shareholders to seek legal redress will limit the ability of responsible owners like HESTA to legitimately exercise its shareholder rights to protect and enhance the long-term value of companies they invest in on behalf of members.

We appreciate that the class action industry contains a number of specialist entities and warrants oversight. Regulation should ensure that the risk premium awarded to entities for the funding of actions is appropriate. Most importantly, regulation and oversight should ensure that the settlement of actions is in the interests of the broader class and system improvement, all entities involved in the funding or pursuit of a claim should prioritise this.

We welcome the opportunity to discuss our submission further. Should you have any queries please contact Mary Delahunty, Head of Impact

## Corporate democracy

The Terms of Reference for the inquiry correctly state that class action activity in Australia is increasing. This is a sign of two things, the maturing health of shareholder rights and poor corporate behavior resulting in shareholder loss.

The increasing activity should change corporate behavior for the better. The Australian Institute of Company Directors (AICD) published an article in September 2018 titled *The growing impact of rising shareholder class actions*, the author notes that "...class actions in Australia have grown steadily rather than exponentially since the introduction in 1991 of a new Part IVA of the *Federal Court of Australia Act 1976* (Cth), which initiated a federal class action regime and paved the way for this country to pioneer litigation funding.

On average, 15.4 class actions have been filed annually in the Federal Court of Australia since 1992, according to research by Professor Vince Morabito at Monash University. Twenty-five class actions were filed in the Federal Court in 2016–17, or less than one per cent of actions. Almost half of all resolved proceedings were settled, often within 12 months." <sup>1</sup> This is despite the several interviewees in the article claiming that Boards were "distracted" by the threat of actions and this is adding to more compliance costs and time for Boards. David Crawford AO FAICD, Chair of South32 and Lendlease is quoted as saying "Australia has become a global capital in litigation funding, mostly for the benefit of law firms and litigation funders rather than the people who suffered the loss in the first place. Too many class actions have little or no real benefit to the community"<sup>2</sup>

The concern seems to be that Australia is becoming overly litigious, our view is that where management has been behaving in a manner that erodes value they are increasingly being held to account.

Attempts to subdue these rights should be resisted, as they excuse poor corporate behaviour and a lack of due diligence on the part of management that ultimately impacts the proper functioning of markets and long-term, sustainable wealth creation. any attempts to excuse poor corporate behaviour or provide excuses for a lack of due diligence on the part of management should also be resisted.

This real or perceived deterrent of possible litigation helps to better align the motivations of shareholders and management. When derivative action legislation was first contemplated in Australia, Professor Ian Ramsay, University of NSW wrote:

"One of the major themes of corporate law concerns the tension between control and accountability. In large public companies managers are given significant discretion in the running of the business. Indeed, this discretion is so broad that it effectively means management control of these companies. This control can lead managers to act in their own interests rather than in the interests of shareholders. Consequently, much of the existing corporate regulatory structure concerns itself with endeavouring to ensure the accountability of managers without unduly encroaching upon their discretionary powers.

---

<sup>1</sup> Tony Featherstone Consulting Editor, AICD Governance Leadership Centre  
<https://aicd.companydirectors.com.au/membership/company-director-magazine/2018-back-editions/october/class-actions>

<sup>2</sup> IBID

The divergence of interest between managers and shareholders results in costs (agency costs) that can be divided into several categories:

- Monitoring costs incurred by shareholders to ensure that managers are acting in the interests of the shareholders.
- Bonding costs incurred by managers with the purpose of assuring shareholders that their interests are being pursued.”<sup>3</sup>

Agency costs – the monitoring costs, can also be lowered by regulation, continuous disclosure obligations and through voting. These tools become blunt instruments without a litigation possibility, adding to the contention that class actions are an important form of corporate accountability and the growth in this activity is an attempt to realign control and accountability.

A key principle of accountability is transparency. Australia’s continuous disclosure obligations are crucial to market integrity, but they should not be confused for the implementation of a class action framework, to do so is to misinterpret the requirements of both. We are concerned about current requests for changes to continuous disclosure obligations. Exhaustive guidance exists to help companies meet the requirements of continuous obligations; it seems though there is a lack of awareness as to the most appropriate actions to take when considering forward-looking information to ensure the market is not misled.

We do not support permanent changes to the continuous disclosure regime, as investors we rely on the accuracy of the information that is provided to determine the value of the company, we ask that the Government resist any changes that may weaken the transparency needed for market integrity and confidence.

## Active ownership

Participation in Class Actions is a form of active ownership.

Active ownership or stewardship refers to the means by which investors most directly influence companies, markets and economies; and, in turn society and the environment. HESTA outlines these principles and duties in our Responsible Investment Policy.

At HESTA, we aim to make a real difference to the financial future of every member. Our responsible investment practices are a crucial part of this purpose as reflected in one of our investment beliefs:

“HESTA will be a responsible investor and recognises that members’ best interests are served by supporting a healthy economy, environment and society.”

HESTA acknowledges that as a ‘universal owner’ we are exposed to the externalities associated with individual portfolio companies. Therefore, to deliver strong financial returns for our members’ financial futures, we must address financial and non-financial considerations and advocate for necessary changes to the financial system. We have a fiduciary duty to act in the best long-term interests of our members and acknowledge that ESG issues can affect the performance of our investment portfolios.

HESTA is recognised as an industry leader in responsible investment. In 2019, we were proud to be named as a global leader by the United Nations Principles for Responsible Investment in its

---

<sup>3</sup> Ian Ramsay. UNSW Law Journal 1992 CORPORATE GOVERNANCE, SHAREHOLDER LITIGATION AND THE PROSPECTS FOR A STATUTORY DERIVATIVE ACTION cited <http://www.austlii.edu.au/au/journals/UNSWLawJl/1992/7.pdf>

inaugural Leaders Group. This group consists of 47 global asset owners at the forefront of responsible investment leadership and innovation.

We take an active ownership role as a part of our responsibility to protect and enhance long-term investment value for members by promoting sustainable value creation in the organisations we invest in.

HESTA believes that our ownership practices can improve long-term risk-adjusted returns to our members. As such, active ownership is entirely consistent with HESTA's fiduciary duty to act in the best interests of our members. In fact, across all ESG issues HESTA believes that good performance will deliver superior returns over the long term and that poor performance constitutes a risk that must be taken into account in investment decisions.

**The Active Ownership Priorities** below outline how we focus our stewardship activities:

**Clear alignment with long-term investors** – we expect companies to create and enhance value for the long term, taking account of the best interests of the company, its shareholders and relevant stakeholders. A company's strategy, policies, culture and conduct, risk management and internal controls, and reporting should reflect and support this goal.

**Transparency and adequate disclosures** – as shareholders and creditors we require transparent and meaningful disclosure from companies for informed decision-making. Companies should publicly disclose all information that is or is expected to be material in the long term, in a timely and complete manner, including any ESG-related issues. Transparency and disclosure are fundamental to the ability of long-term investors like HESTA to accurately price risk and to identify where we can use active ownership to improve the long-term value of companies for the benefit of members.

**Management of ESG risks** – we expect companies to manage for a wide range of risks within their business including material ESG risks.

**Addressing of externalities and systemic risks** – we expect companies to act in a sustainable and responsible way considering how their business contributes to system-wide issues and their implications in the health of the economy, environment and society where they operate now and in the future. This includes considering and managing in the present risks that might emerge in the long term. Examples of such issues are climate change, social inequality, environmental degradation and tax avoidance.

**Consider their contribution to the United Nations Sustainable Development Goals (SDGs)** – we encourage companies to assess and measure how they can contribute to the achievement of the SDGs and enhance those activities that have a higher positive impact in society and the environment. We believe companies can benefit from delivering products and services that help solve for the world's biggest challenges highlighted by the SDGs and contribute to a healthy economy, environment and society.

As a long-term investor where we expect to own an asset for a number of years, active ownership is especially important in serving the interests of our members.

**Active ownership includes:**

**Engagement** - entering into a dialogue with companies to better understand their business model and to influence their performance and practices in line with our Active Ownership Priorities. It also includes the dialogue we have with our external investment managers to encourage progress in their ESG integration practices.

**Voting** – exercising our voting rights in both listed and unlisted markets is a key element of our stewardship activities and an important link in the chain of accountability between a company and its shareholders (and an investment manager and its investors). The right to vote at company shareholders' meetings (or as unitholders) is a fundamental part of a well-functioning corporate governance system.

**Legal action** - Class actions allow shareholders, as a collective group, to claim for losses against a company where a reasonable case can be made that the loss occurred due to breaches of corporate laws or regulations. HESTA participates in class actions to recover losses but also as a means of encouraging better standards of corporate governance and improved accountability by companies, directors and corporate advisors to their shareholders.

Through the tools available to active owners, including the participation in class actions we can most effectively influence a company to adequately address ESG issues. In this way, active ownership will not only lead to improved performance at the company level but has the potential to result in improved performance across the system.

### **Recommendation for the focus of reform**

We recommend the Government respond to the ALRC report *Integrity, Fairness and Efficiency – An Inquiry into Class Action Proceedings and Third-Party Litigation Funders* which was released in 2018 and the reform suggestions contained therein.

Any areas of reform should be focused on facilitating a well-regulated class actions system without seeking to stifle what is an important part of democratic capitalism. It is critical that reform not stifle the capacity for individual shareholders to enforce their rights. The growth of class actions in Australia should be regarded as a maturing of corporate democracy, not as a development that needs suppression.

HESTA considers that, if class action funders are required to hold an Australian financial services licence, the general obligations would provide an adequate level of regulation. HESTA is concerned that the treatment of each class action as a registrable managed investment scheme would create such a compliance cost burden that it would defeat the stated purpose of ensuring greater returns to class members.