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PARLIAMENTARY JOINT COMMITTEE ON CORPORATIONS AND FINANCIAL SERVICES

SUBMISSION OF MAURICE BLACKBURN PTY LIMITED ON FINANCIAL PRODUCTS AND SERVICES IN AUSTRALIA

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4 September 2009

Ms Shona Batge
The Committee Secretary
Parliamentary Joint Committee on Corporations and Financial Services
Parliament House
CANBERRA ACT 2600

By email: corporations.joint@aph.gov.au

Dear Ms Batge,

Re: Inquiry into Financial Products and Services in Australia

We make these submissions in response to the Parliamentary Joint Committee's inquiry into financial products and services in Australia.

Maurice Blackburn Pty Limited is a national plaintiff law firm with offices in New South Wales, Victoria and Queensland. Maurice Blackburn has acted in a number of significant legal cases representing consumers of financial products and services. We are market leaders in the field of class actions acting for groups, individuals, shareholders and businesses who have suffered losses arising from illegal corporate behaviour, including misleading and deceptive conduct and breaches of continuous disclosure obligations. Maurice Blackburn has also acted in a variety of commercial litigation matters for users of financial products and services in a number of different jurisdictions ranging from small scale matters to large and complex commercial matters including actions against financial planners and advisers.

In representing the interests of our clients, the status of any insurance cover maintained by defendants or proposed defendants in the matters in which we act impacts heavily on the prospects of recovering damages for our clients.

In relation to the terms of reference issued by the Parliamentary Joint Committee, these submissions will focus on points 8 and 9 of those terms of reference:

8. *The adequacy of professional indemnity insurance arrangements for those who sold the products and services, and the impact on consumers; and*

9. *The need for any legislative or regulatory change.*

The adequacy of Professional Indemnity insurance arrangements

We consider that the current regulatory and legislative regime in respect of Professional Indemnity ("PI") insurance is inadequate in that it does not allow for proper compensation for shareholders or consumers who have been the victims of corporate misconduct or negligent financial advice. As such, we do not consider that PI insurance is an effective mechanism for consumer protection. As a result, too many of our clients who are consumers of financial products and services in Australia, are left without adequate compensation notwithstanding successful claims being brought against corporate wrongdoers or financial advisers.

Some of the reasons for the inadequacy of PI insurance are as follows:

1. The effect of exclusion clauses forming part of PI insurance policies which limit the application of the policy, particularly where the exclusion pertains to one of the key financial services that the insured provides to consumers. Exclusions also often limit the application of the policy to financial products on an approved products list;

2. Monetary limits on liability which significantly limit the amount that can be recovered under PI insurance policies and, in particular, where such limits include the legal costs of defending claims brought against the insured; and

3. The requirements of a "claims made" insurance policy whereby notice of a claim needs to be made within the period stated in the insurance policy giving rise to the impediment that the notification period may already have expired before the client is aware that they have suffered a loss.

As the law currently stands, there are very limited avenues available to plaintiffs to obtain information in relation to the insurance status of defendants or proposed defendants prior to the commencement of proceedings or throughout its conduct. This significantly hampers our ability to advise our clients on such aspects as recoverability and to properly assess the prospects of recoverability. Often it is not until considerable funds have been spent in pursuing an action that it is revealed that there is no responding insurance policy or there is a limit on the liability in a responding insurance policy.

There is no obligation on a defendant or potential defendant to disclose details of its insurance policy or policies to a plaintiff at any stage of a proceeding. In order to make a proper assessment of the prospects of ultimate recovery, ideally the plaintiff would be assisted by knowledge of the following:

(a) the identity of the insurer;

(b) the terms and conditions of the insurance contract including any exclusion clauses;

(c) the details of notification of claims or circumstances by the insured;

(d) whether there has been a denial of any liability; and

(e) whether there are any limits on liability in respect of the insurance policy.

Courts are reluctant to permit discovery of a defendant's insurance documents on the basis that it is not normally relevant to the issues between the plaintiff and the defendant notwithstanding that it is relevant to recoverability. This gives rise to practical problems for the conduct of litigation on behalf of plaintiffs, particularly in large shareholder matters.

Further, a third party seeking to recover under a professional's PI insurance policy has no automatic right to seek payment under the policy, having no privity of contract with the insurer. Case law demonstrates that it is difficult to join insurers as a third party to a litigation and therefore the plaintiff will have no direct claim against the insurer unless extenuating circumstances exist.

The situation is exacerbated by the lack of recourse that plaintiffs have against any insurer who funds and runs an unmeritorious defence. In particular, where there is a monetary limit on liability, the majority or the entirety of the limited funds available can be spent on defence costs even where that defence does not have any reasonable prospects of success. The likely result of this is, when the plaintiff succeeds in its claim against a defendant with an unmeritorious defence, there may not be sufficient funds to compensate it for its loss

because the entire proceeds available under the limited insurance policy have been spent on defending the claim.

The introduction of the proportionate liability regime in each Australian jurisdiction has caused additional prejudice to plaintiffs in this regard as, under this regime, if a plaintiff succeeds against multiple defendants they will no longer be jointly and severally liable for its loss. The plaintiff therefore bears the risk of proceeding against impecunious defendants or where there are limits on liability or exclusion clauses operating to restrict the amount that can be recovered under insurance policies maintained by defendants.

Case Study 1: Rod Investments (Vic) Pty Ltd v William Abeyratne (as Trustee in Bankruptcy of Adam Clark) & Ors

A class action has been commenced representing a large number of shareholders who purchased shares in a publicly listed company based on representations made to them, which representations it is alleged were misleading and deceptive. The company subsequently went into liquidation and the shareholders have suffered losses of an estimated $35-$40 million in funds invested by them in purchasing shares in the company.

There are multiple defendants in the above matter. Judgment has been obtained against four of those defendants. One defendant has entered into voluntary bankruptcy. Two of the corporate defendants are in liquidation. Of the remaining defendants, a number are claiming to be impecunious.

One of the defendants, a corporate stock broking firm in the business of providing advisory services relating to capital raising, maintained a PI insurance policy. This policy contains an exclusion clause for capital raising which was the very activity being conducted by the defendant giving rise to the claim for misleading and deceptive conduct.

A second insurance policy maintained by one of the other defendants is subject to a limit on liability of $1 million including defence costs. This was only disclosed to the plaintiff after significant funds had been expended in progressing the claim both by the plaintiff and by the insured who had used up a substantial portion of the limited insurance funds available.

The effect of the above is that shareholders with claims for in excess of $35 million in loss and damage may not be able to recover all or any of the losses sustained by them by way of compensation due to:

(a) the effect of the exclusion clause in the insurance policy in respect of capital raising;

(b) the limit on liability of $1 million including defence costs; and

(c) the impecuniosity of the defendants.

Case Study 2: Ackers & Ors v Austcorp International

Separate claims were commenced on behalf of multiple purchasers of apartments in a resort development in New South Wales. It was alleged that the purchases were entered into in reliance on misleading and deceptive representations contained in advertising brochures produced by the real estate agent, the land owner, the developer and the guarantor of the development.

Proceedings were commenced against five respondents. One of the respondents went into liquidation. Two of the other respondents claimed impecuniosity and claims against them were settled. Just prior to the commencement of the trial of test cases it was disclosed that there was a limit on liability in respect of a responding insurance policy maintained by one of the defendants, most of which had already been spent on defence costs. The claim against that defendant was also subsequently settled with an exceedingly poor outcome for the claimants.

The matter proceeded against the remaining respondent who claimed not to have any responding insurance policy however no proof has ever been forthcoming as to its insurance status. Judgment was ultimately obtained in favour of two of three test case applicants and damages were ordered to be paid by that respondent. There are now however significant concerns over its continuing financial viability and, in circumstances where there has been no admission of liability by any insurer and no disclosure regarding any insurance policy held by that respondent, it remains to be ascertained whether any funds will be recovered on behalf of the two successful test case applicants or the remaining applicants whose cases are yet to be determined.

The case studies above highlight the particular problems with the inadequacy of PI insurance which, we submit, need to be addressed by the legislative bodies and by this Joint Committee.

Recommendations

In our submission, there are measures that could be adopted by the Joint Committee to address some of the problems identified by us in this submission including the following:

1. Consider making legislative provision for disclosure of details of PI insurance cover or extending the current regulatory provisions in respect of preliminary discovery to include third party discovery to enable the production of any relevant insurance policies held by defendants or proposed defendants at an early stage in litigation;

2. Consider legislating to make remedies available to third parties against insurers who fund unmeritorious defences, particularly where limits on liability exist in the insurance policies, to enable plaintiffs to have a right of recourse against such insurers;

3. Consider establishing a compensation fund from which compensation to consumers could be made;

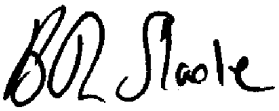
4. Consider amending legislation to ensure regulation of requirements on licensed financial service providers and other professionals to have adequate insurance

policies which do not contain exclusion clauses that exclude them from the provision of services which they are licensed to provide; and

5. Improve and enhance monitoring of compliance with regulatory procedures.

For the reasons set out in this submission, we consider that the above recommendations would signal positive reform and would significantly redress the inadequacy of PI insurance and the injustice which flows to many consumers who have suffered loss as a result of corporate wrongdoing but have limited prospects of being adequately compensated for such losses.

Yours faithfully,
MAURICE BLACKBURN



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