NEW ZEALAND'S EXCHANGE
TE PAEHOKO O AOTEAROA
NZX Limited
Level 1, NZX Centre
11 Cable Street
Wellington 6140
New Zealand

www.nzx.com

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Consultation Paper on Class Actions and Litigation Funding
Level 9, Solnet House
70 The Terrace
Wellington 6011
Aotearoa, New Zealand

By e-mail only: cal@lawcom.govt.nz

NZX Submission: Consultation Paper on Class Actions and Litigation Funding

1. NZX Limited (**NZX**) is pleased to submit this response to the Law Commission's consultation paper on class actions and litigation funding (**Consultation Document**).

2. We thank the Law Commission for the opportunity to make this submission and look forward to contributing to the development of the settings for class actions and litigation funding in Aotearoa, New Zealand. Nothing in this submission is confidential.

About NZX

3. NZX is a licensed market operator and New Zealand's exchange. NZX operates New Zealand's securities, debt, funds, derivatives and electricity markets. NZX has approximately 200 listed issuers with a total market capitalisation of approximately $233 billion, who will be affected by the matters raised in the Consultation Document.

4. In 2019, NZX and the FMA co-sponsored the commission of the Capital Markets 2029 report which comprised an industry-led effort with the support of Ernst & Young.[1] The Capital Markets 2029 Committee's mandate was to review the current state of New Zealand's capital markets and identify potential avenues for improvement and growth over the coming decade. The broader impacts of regulation, class action litigation and litigation funding were explored by the Capital Markets 2029 Committee, the findings of which are discussed further in this submission.

Response to consultation questions

5. We wish to submit on the specific issues raised in the Consultation Document which we believe best fall within our field of expertise and will constructively benefit the Law Commission with its consultation. We have separated our submission into the following three main issues:

- creation of a statutory class action regime;
- types of available class actions; and
- litigation funding.

[1] Capital Markets 2029, *Growing New Zealand's Capital Markets 2029*, is available here

Issue 1: Creation of a statutory class action regime

Chapter 7: A statutory class actions regime for Aotearoa New Zealand

Q5. Should Aotearoa New Zealand have a statutory class actions regime? Why or why not?

Yes

6. We support the opinion expressed in the Consultation Document that the current representative action system prescribed by High Court Rule 4.24 obscures the key features and application of a class actions regime. Academics and practitioners have suggested legislative reform is urgently required as the current regime is inefficient; expensive; does not comply with access to justice, or rule of law values; and causes too much commercial and legal uncertainty. The courts have expressed a clear desire for having detailed legislative rules for determining and managing representative actions. We consider that this would be best suited to a statutory regime.

7. We support a statutory class actions regime as preferable to a judicial regime, as it will provide greater certainty, enable better natural justice outcomes and reduce the costs and other negative externalities (such as insurance premiums) associated with a less efficient system. A statutory regime would also reduce the judicial burden on the courts, which would be encumbered should the judiciary be given the task of defining the class actions regime through High Court Rule 4.24.

8. The statutory regime should be detailed enough to provide clarity to the courts on its application (including through the prescription of the eligibility requirements for class actions), while being broad enough to enable the courts to refine the regime. We believe that the legislature would be best equipped to determine these settings through Select Committee engagement.

Chapter 8: Scope of a statutory class actions regime

Q6. Should a class actions regime be general in scope or should it be limited to particular areas of the law?

The class actions regime should be applied consistently across all areas of law, to enhance certainty for claimants and defendants.

9. While it will be important that the class actions regime is calibrated correctly, on an opt-in basis and utilising the role of existing regulators for capital markets actions, we consider that a statutory class-actions regime is likely to provide greater clarity for claimants and defendants, and should be applied to all areas of law. We do not consider that a class actions regime should act as a substitute for existing regulatory regimes (such as those enforced by the Financial Markets Authority (**FMA**)) which have a wider range of appropriate tools for ensuring compliance.

Q8. Should a class actions regime include defendant class actions?

Yes

10. We consider that it would be equitable and in the best interests of the New Zealand judicial system to allow for defendant class actions in instances where such actions are justified.

Q9. Should the representative actions rule be retained alongside a class actions regime? For which kinds of case?

Yes, the representative actions rule should be retained alongside a class actions regime and its application should be at the discretion of the courts.

11. We submit that the courts should, by default, apply the statutory class actions regime whenever applicable. However, the representative actions rule should be retained to provide the Court with residual discretionary powers not provided for by the statutory regime. This may be required as a class actions regime is being introduced into an area of law where there may be potentially unforeseen procedural issues. In such cases, we believe that the representative actions rule should be preserved so that a Court may call upon such powers to continue a claim irrespective of any failures of a new class actions regime.

Chapter 9: Principles for a statutory class actions regime

Q11. Which features of a class actions regime are essential to ensure the interest of plaintiffs and defendants are balanced?

The involvement of regulatory bodies as lead claimants where applicable, particularly in relation to financial markets.

12. New Zealand's capital markets operate in a highly regulated environment with oversight from the FMA, Commerce Commission and the Overseas Investment Office. This system is designed to promote the confident and informed participation of businesses, investors and consumers, and to promote and facilitate fair, efficient and transparent financial markets. We consider that the inherent protections that arise from this regulatory oversight should be leveraged as part of the introduction of a statutory class actions regime.

13. We suggest that the statutory class actions regime incorporate additional powers for regulatory bodies to bring class action claims as a lead claimant. This would be facilitated through a requirement for class actions to involve the appropriate regulatory body to act as a lead claimant. We anticipate that the involvement and experience of appropriate regulatory bodies would function as a suitable check and balance against meritless or vexatious claims, resulting in a more efficient class actions regime for New Zealand.

14. We caution against adopting a class actions regime similar to Australia's, the results of which have been disproportionate for defendants and the broader market through the increase in costs associated with the inherent risk of a class action, without significantly improving investor protection. A significant number of securities law class actions have been taken in the United States and Australia, and we are concerned about the disproportionate effects on issuers and the New Zealand economy if the class actions regime is not correctly calibrated. This may be exacerbated because a number of corporate and securities liability offences are currently framed as 'strict' liability, where no 'mens rea' or intention element is necessary, which in some instances is necessary to ensure the efficient operation of New Zealand's capital markets. We suggest that the introduction of a statutory regime will need to carefully

consider the nature of these offences, to ensure that there is not a disproportionate effect on defendants.

Chapter 10: Certification and threshold legal test

Q19. Should a class action regime include a certification requirement? If not, should the court have additional powers to discontinue a class action (as in Australia)?

We support the court having the ability to consider whether a class action should proceed.

15. We support the incorporation of a certification stage or alternative process similar to the certification process seen in most jurisdictions with well-established class action regimes. This process should be carefully calibrated to ensure that it does not determine the outcome of the proceeding, by acting as the impetus for a defendant to determine whether to settle the action. Class action claims can sometimes be weaponised as a form of 'legal blackmail', as seen with certain class action claims in the United States and Australia. Such predatory, vexatious or negligent class action claims often have a detrimental and irreparable impact on the defendant's reputation, ultimately causing inefficiencies in the macro-environment as negative externalities are created, for example through increased insurance premiums.

16. We consider that it is appropriate for the courts to determine whether a class action should proceed at its outset, particularly for actions relating to alleged breaches of financial markets legislation, given the broader detrimental effects of vexatious claims on New Zealand's capital markets. We note the Australian experience where a lack of a certification or other gating process has contributed to increased premiums for directors' and officers' liability insurance.

Issue 2: Types of available class actions

Chapter 12: Membership of the class

Q32. Should class membership be determined on an opt-in or an opt-out basis or should different approaches be available?

Opt-in

17. While we suggest that each of the 'opt-in', 'opt-out' and universal regimes remain available in New Zealand, we consider that the 'opt-in' regime will be appropriate for most types of class action, including those relating to corporate litigation matters and alleged breaches of New Zealand's financial market obligations. We again note the comments of Capital Markets 2029, that an appropriate balance between enabling investor redress and the avoidance of vexatious claims for corporate litigation would be served by an 'opt in' regime for class actions, rather than the current 'opt-out' approach taken by Australia.[2] The class action regime in Australia appears to have been calibrated in a manner that has resulted in a disproportionate number of claims being taken against directors and issuers.

[2] Capital Markets 2029, *Growing New Zealand's Capital Markets 2029* at p.38

18. An opt-in approach will help to reduce some of the negative effects associated with the broadening of the class actions regime. We have begun to see the effects of the hardening of the directors' and officers' insurance market in New Zealand with premiums in some cases increasing by as much as 300% in comparison to 2020. This is further corroborated by the increase of directors' and officers' insurance premiums in Australia where the average rate for public companies has increased by 229% and retention for public companies has increased by 279% for 2020 alone.[3] Notably, we understand that this has caused 6 insurers to exit the Australian directors' and officers' insurance market in 2020.

Q33. If the court is required to decide whether class membership should be determined on an opt-in, opt-out or universal basis, what criteria should it apply? Should there be a default approach?

Class membership should generally be determined on an opt-in basis. Membership on an opt-out should only be applicable for matters of public importance or for matters against the Crown.

19. We suggest implementing an 'opt-in' regime as the default standard, and an 'opt-out' regime for non-corporate claims and where classes of claimants are easily identifiable. We anticipate 'opt-out' class actions to predominantly involve matters of public interest brought against the Crown.[4]

20. We support the application of an 'opt-in' basis of class action membership for most types of claims, as currently seen in the vast majority of representative actions in New Zealand. Where there is ambiguity in the application of the new class action regime, an 'opt-in' regime will benefit from the precedents established by representative actions. An 'opt-in' approach will also provide for greater commercial certainty and quantification of risk for New Zealand issuers and commercial entities, and reduce the burden on claimants. In contrast, class membership on an 'opt-out' basis could give rise to opportunistic claimants creating an over-litigious legal system.

21. As noted in response to Q11, we would encourage the involvement of regulatory bodies to bring class actions on behalf of large and easily identifiable classes of claimants, which will enable a greater quantification of risk and commercial certainty for directors and issuers, while preserving access to justice for larger classes of claimants.

Issue 3: Litigation funding

Chapter 17: Advantages and disadvantages of litigation funding

Q38. Is litigation funding desirable for Aotearoa New Zealand in principle?

Yes, but the settings for litigation funding should ensure that the class actions regime operates in a proportionate manner.

[3] Information provided by Marsh Inc.

[4] Law Commission Issues Paper: *Class Actions and Litigation Funding* at para. 6.14, pg. 117

22. We note that litigation funders currently already operate in New Zealand. While we support the access to justice that these litigation funders provide for New Zealanders, we suggest that the appropriate regulatory bodies establish a licensing regime to ensure the financial regulation of litigation funders and ensure that the class actions regime operates in a proportionate manner.

Chapter 21: Funder profits

Q51. What concerns, if any, do you have about funder profits?

We are concerned of the movement of funder profits out of New Zealand and the potential impact on the costs and diversity of directors in New Zealand.

23. As many current and potential litigation funders are based in Australia, we foresee such entities more aggressively entering the New Zealand market once a statutory class actions regime is formalised. We suggest that the Commission consider the benefits of the entry of established experienced litigation funders in New Zealand, along with the possibility of litigation funder profits being taken offshore by these entities.

24. An increase in litigation funding will likely result in an increase in class actions, which in turn is likely to increase costs, narrow coverage and decrease the availability of directors' and officers' liability insurance. Difficulties with directors' & officers' liability insurance coverage will result in a struggle for issuers to attract, retain and develop capable and experienced directors, narrowing the pool of directors in New Zealand. This could in turn negatively impact the rate of incorporation of companies in New Zealand and result in the privatization of public corporate entities as they seek to reduce risk of class action litigation and costs, impairing the growth of our capital markets.

25. A lack of a diverse pool of director candidates and corporate entities in New Zealand would likely also negatively affect our ease of business ranking, commercial development and productivity, as these important features encourage foreign investors and businesses to establish operations within New Zealand. Therefore, we would suggest the regulatory settings for litigation funding are designed to ensure an appropriate balance between providing access to redress for investors and the negative effects of vexatious actions.

Q52. Are you satisfied that existing mechanisms can adequately manage the concerns about funder profits?

No

Q53. If not, which option for managing the concerns about funder profits do you prefer, and why? For example:

a) Should competition in the litigation funding market be encouraged? If so, how?

Yes, by instilling a cap to encourage syndicated funding.

26. We anticipate that, given the size and experience of litigation funders which currently operate in Australia and overseas, the establishment of a New Zealand class actions regime will attract an influx of foreign litigation funders. While New Zealand will

benefit from the involvement of more experienced litigation funders, which will increase competition within the litigation funding market, we suggest that it is important that litigation funding to be appropriately regulated to avoid a rise in the costs for all corporate entities associated with the inherent risk of a rise in vexatious litigation actions.

27. We support the creation of a cap on funder commissions. Capping funder profits, should encourage syndicated funding among litigation funders enabling smaller, potentially local litigation funders to participate in litigation funding as opposed to being monopolised by already well-established foreign entities. A cap will also operate to disincentivise vexatious claims and create greater certainty for corporate entities on the inherent risks of a class actions regime.

b) Should the courts be empowered to vary funder commissions? If so, when, and how?

Yes, up to the court's discretion on when and how to do so.

28. As a statutory class actions regime would be relatively new to New Zealand, we support granting the courts discretionary power to adjust funder commissions to the extent that they deem necessary in the interest of facilitating justice.

c) Should funder commissions be regulated? If so, should there be restrictions on how funder commissions can be calculated (and if so, what) or should funder commissions be capped (and if so, how)?

Yes, by way of a multiplier and multiplicand system similar to the calculation of damages in personal injury litigation in other jurisdictions

29. We suggest that funder commissions should be capped, by creating and applying a 'multiplier and multiplicand' tabled system similar to personal injury claims. A multiplicand is a lump sum calculation which should represent the conservative basis figure of an award to an individual claimant while factoring in any potential costs involved and a multiplier should then be applied to the multiplicand based on the number of claimants in the class action. Together, the multiplier could provide a methodology that would ensure an appropriate limit is set on funder commissions.

Closing comments

30. We support the Law Commission's views regarding the need for a statutory class actions regime provided that such a regime operates on an opt-in basis for class membership as currently seen with the majority of representative class actions in New Zealand.

31. Our capital markets have been carefully calibrated through a highly regulated landscape that relies on specialist regulators to enforce market integrity and investor protection mechanisms. New Zealand's capital markets are subject to oversight from the FMA, Commerce Commission and the Overseas Investment Office, who are collectively responsible for protecting the rights and interests of investors. We would support a class actions regime that leverages the role of existing regulatory bodies, and takes account of existing regulatory tools which may be more appropriate to remedy a breach.

32. We support the introduction of regulatory settings for litigation funders that take account of the impact of a rise in the inherent risk of class actions on directors' and officers' liability insurance premiums.

33. We would like to thank the Law Commission for this opportunity to submit on these proposals. We would welcome the opportunity to discuss any aspect of this submission with you.

Yours faithfully,

Kristin Brandon
Head of Policy and Regulatory Affairs
NZX Limited