

SHAREHOLDER CLASS ACTIONS IN AUSTRALIA – THE PERFECT STORM?

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I INTRODUCTION

Shareholder class actions are a recent but growing phenomenon on the Australian legal landscape. Seven out of ten new class actions are now shareholder related,¹ and Australia's largest litigation funder, IMF (Australia) Limited, is bracing itself for an increase in class actions over the next few years.² The use of the class action for shareholder claims was foreseen by the Australian Law Reform Commission in 1988 when it recommended the enactment of a class action procedure in Australia,³ and by the Federal Attorney-General in 1991 during the Second Reading Speech for the federal class action procedure.⁴ However, shareholder class actions have only been regularly commenced in the courts since approximately 2004. Prominent examples of the shareholder class action are the proceedings commenced against GIO, Telstra, Concept Sports, Harris Scarfe, HIH, the Australian Wheat Board, Multiplex, Aristocrat Leisure, Village Life and Centro Property Group. If claims against insolvent corporations by shareholders are included, then the Sons of Gwalia, Ion and Media World actions may be added.

The aim of this article is to explain why the number of shareholder class actions is increasing. Indeed, the thesis advanced in this article is that there has been a convergence of factors that has led, and will continue to lead to greater litigation in relation to shareholder claims – a perfect storm. The rise of the shareholder class action may be explained through the transformation theory of

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1 Sundeep Tucker, 'Culture of Class Action Spreads Across Australia', *Financial Times* (London), 9 March 2006, 12.

2 Adele Ferguson, 'Class Actions on the Increase', *The Australian* (Sydney), 4 January 2008, 15.

3 Australian Law Reform Commission, *Grouped Proceedings in the Federal Court*, Report No 46 (1988), [65].

4 Second Reading Speech, Federal Court of Australia Amendment Bill 1991 (Cth), House of Representatives, 14 November 1991 (Michael Duffy, Attorney-General of Australia). The Attorney-General stated that '[t]he new procedure will mean that groups of persons, whether they be shareholders or investors, or people pursuing consumer claims, will be able to obtain redress ...': 3177

how experiences become grievances which in turn become disputes.⁵ The theory of transformation involves three steps:

- naming – saying to oneself that a particular experience has been injurious;
- blaming – a person attributes an injury to the fault of another individual or entity; and
- claiming – voicing a grievance to the person or entity believed to be responsible and seeking a remedy.⁶

From an economic perspective, the process of claiming assumes that the person is rational and will only pursue a claim if the expected recovery exceeds the costs of bringing the case.⁷ Moreover, the rate at which an injury is transformed into a remedy, which might be labelled litigiousness, will vary depending upon costs, availability of financing and likely compensation.⁸ This article argues that costs have been reduced, financing has been introduced and the prospects of successfully obtaining compensation have increased, through a number of developments in the Australian legal system. These developments are new causes of action based on misleading and deceptive conduct and the continuous disclosure regime, access to evidence collected by the Australian Securities and Investments Commission ('ASIC'), the availability of the class action as a procedural vehicle and litigation funding. Consequently the transformation of a share price fall or corporate collapse into shareholder litigation has been made more likely. Put simply, the combination of the above factors makes claiming viable. When a lawyer is approached by a shareholder, even in relation to a small claim, the lawyer is no longer likely to counsel the client that 'the grievance is not serious, cannot be remedied or is simply not worth pursuing'.⁹ To the contrary, the shareholder will be encouraged to seek a remedy or, more precisely, to execute a retainer and litigation funding agreement.

Economic factors, while clearly important, do not fully explain why or how injuries become claims. As such, academics have looked at psychological and sociological explanations which have recognised the significance of cultural

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- 5 William Felstiner, Richard Abel and Austin Sarat, 'The Emergence and Transformation of Disputes: Naming, Blaming, Claiming' (1980–81) 15 *Law and Society Review* 631, 632. See also Herbert Kritzer, 'Propensity to Sue in England and the United States of America: Blaming and Claiming in Tort Cases' (1991) 18 *Journal of Law and Society* 400, 401–2; see also Austin Sarat, 'Exploring the Hidden Domains of Civil Justice: "Naming, Blaming and Claiming" in Popular Culture' (2000) 50 *DePaul Law Review* 425.
- 6 Felstiner, Abel and Sarat, above n 5, 635–6.
- 7 Frederick C Dunbar and Faten Sabry, 'The Propensity to Sue: Why Do People Seek Legal Actions?' (Working Paper, National Economic Research Associates Economic Consulting, 2004), 4 <<http://ssrn.com/abstract=541183>> at 6 September 2008.
- 8 See Kritzer, above n 5, 422; Donald N Dewees, J Robert S Prichard and Michael J Trebilcock, 'An Economic Analysis of Cost and Fee Rules for Class Actions' (1981) 10 *Journal of Legal Studies* 155; and J Robert S Prichard, 'A Systematic Approach to Comparative Law: The Effect of Cost, Fee, and Financing Rules on the Development of the Substantive Law' (1988) 17 *Journal of Legal Studies* 451.
- 9 See Felstiner, Abel and Sarat, above n 5, 647.

factors, perceptions and personality for blaming others.¹⁰ In the shareholder class action context, the two cultural or sociological changes that have spurred litigation are, first, the introduction of consumerism into share ownership and, secondly, institutional investors taking on the role of class action participant.

This article explains how these developments in law and society have combined to promote shareholder class actions. The ‘perfect storm’ analogy is adopted because of the unique interaction of factors which would be less powerful if they had occurred alone. The effect of these factors, in combination, has been to increase the likelihood of shareholder class actions. This article also stands in contrast to past scholarship that has argued that the legal avenues for shareholders who have suffered loss to obtain redress are characterised by economic disincentives and difficulties in establishing substantive rights.¹¹

II A PROPENSITY TO SUE

A Investors as Consumers

Consumerism has been defined in a number of ways,¹² but the term is used here in the sense of the movement aimed at educating consumers as to their rights and protecting their interests.¹³ Consumerism arose as a response to the metamorphosis of society from one based primarily on individual relationships to one in which production, distribution and consumption have become mass phenomena.¹⁴ Globalisation has added to these mass phenomena by extending production, distribution and consumption beyond national boundaries and markets.¹⁵

Consumerism focuses on how the consumer’s lack of bargaining power and the existence of information asymmetry expose the consumer to certain risks, such as receiving a defective or unsuitable product, or personal injury.

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- 10 Dunbar and Sabry, above n 7, 7; Julie Paquin, ‘Avengers, Avoiders and Lumpers: The Incidence of Disputing Style on Litigiousness’ (2001) *Windsor Yearbook of Access to Justice* 3; Dan Coates and Steven Penrod, ‘Social Psychology and the Emergence of Disputes’ (1980–81) 15 *Law and Society Review* 655.
- 11 Julian Donnan, ‘Class Actions in Securities Fraud in Australia’ (2000) 18 *Company and Securities Law Journal* 82, 82; Michael Duffy, ‘Shareholder Democracy or Shareholder Plutocracy? Corporate Governance and the Plight of Small Shareholders’ (2002) 25(2) *University of New South Wales Law Journal* 434, 460; Cara Waters, ‘The New Class Conflict: The Efficacy of Class Actions as a Remedy for Minority Shareholders’ (2007) 25 *Company and Securities Law Journal* 300, 314.
- 12 Consumerism may be defined as equating personal happiness with purchasing material possessions and consumption, as identifying strongly with a particular brand or product, and as an economic policy that emphasises consumption. See generally, Clive Hamilton and Richard Denniss, *Affluenza* (2005).
- 13 CCH Australia, *The CCH Macquarie Dictionary of Business* (1993) 128; Christopher Pass, Bryan Lowes and Leslie Davies, *Economics Dictionary* (3rd ed, 2000) 91.
- 14 Mauro Cappelletti, ‘Alternative Dispute Resolution Processes Within the Framework of the World-Wide-Access-To-Justice Movement’ (1993) 56 *Modern Law Review* 282, 284; Luisa Antonioli, ‘Consumer Law as an Instance of the Law of Diversity’ (2006) 30 *Vermont Law Review* 855, 856–8.
- 15 John Wiseman, *Global Nation? Australia and the Politics of Globalisation* (1998), 18–19; John Goldring, ‘Consumer Protection, Globalization and Democracy’ (1998) 6 *Cardozo Journal of International and Comparative Law* 1, 5; and Antonioli, above n 14, 860.

Consumerism advocates for those risks to be shared with large corporations that have a much greater degree of power in the consumer–producer relationship and can more efficiently take steps to reduce those risks.¹⁶ The concept embodies a perception that if a product does not perform as expected it is the fault of the manufacturer or seller. It also involves empowerment whereby a remedy is expected if a product or service does not operate as expected. This is an aspect of the more general development in Western societies of individuals being better informed and seeing themselves as having certain rights.¹⁷

The thinking behind consumerism has been transferred to share ownership. Shares are seen as just another product that a consumer may decide to expend funds on. This has given rise to the consumer–investor. In *Sons of Gwalia Ltd v Margaretic*, Gleeson CJ observed:

modern legislation ... has extended greatly the scope for ‘shareholder claims’ against corporations Corporate regulation has become more intensive, and legislatures have imposed on companies and their officers obligations, breach of which may sound in damages, for the protection of members of the public who deal in shares and other securities.¹⁸

Equally, Kirby J characterised a purchaser of shares as ‘a consumer of corporate information’.¹⁹ The Parliamentary Joint Committee investigating the structure and operation of the superannuation industry repeatedly referred to consumers in describing superannuation fund members and describes ASIC as being responsible for ‘consumer protection’.²⁰

The consumer–investor phenomenon in Australia can probably be traced back to five key events:

- the Federal Government’s decision to promote private superannuation as a substitute for government-funded old age pensions;
- the privatisation of major government entities such as Telstra, Qantas and the Commonwealth Bank;
- the wave of demutualisations that began in the late 1980s, including AMP and NRMA, and more recently NIB;

16 Jason Cornwall-Jones, ‘Breach of Contract and Misleading Conduct: A Storm in a Teacup’ (2000) 24 *Melbourne University Law Review* 249, 251; Iain Ramsay, ‘Consumer Law, Regulatory Capitalism and the “New Learning” in Regulation’ (2006) 28 *Sydney Law Review* 9, 9; Antonioli, above n 14, 856.

17 Basil Markesinis, ‘Litigation-Mania in England, Germany and the USA: Are we so Very Different?’ (1990) 49 *Cambridge Law Journal* 233, 254; Marc Galanter, ‘Litigation in America – Reading the Landscape of Disputes: What We Know and Don’t Know (and Think We Know) About Our Allegedly Contentious and Litigious Society’ (1983) 36 *UCLA Law Review* 4, 69.

18 (2007) 231 CLR 160, 180. See *Sons of Gwalia v Margaretic* (2007) 231 CLR 160, 207 (Kirby J). See also, Stephen Bartholomeusz, ‘High Court Decision Opens Can of Worms for Handling Large Scale Insolvencies’, *The Age* (Melbourne), 1 February 2007, 8: ‘In the Gwalia case, however, the claim brought by a shareholder, Luka Margaretic, wasn’t made in his capacity as a shareholder but, in effect, as a consumer who had been the victim of misleading and deceptive conduct by the company’.

19 *Sons of Gwalia Ltd v Margaretic* (2007) 231 CLR 160, 210.

20 Parliamentary Joint Committee on Corporations and Financial Services, Parliament of Australia, *Inquiry into the Structure and Operation of the Superannuation Industry* (2007), xviii, xx, 8–9 and Ch 6. See also, *Australian Securities and Investments Commission Act 2001* (Cth) s 1(2)(b) (‘ASIC Act’).

- the reduction in the cost of share transactions and access to share trading provided as a result of the internet; and
- the wealth generated and lost by the dot-com boom/bust through share trading and initial public offerings.²¹

Consequently, share ownership became accessible to, and desirable for, the general public. Share ownership figures reported by the Australian Securities Exchange ('ASX') show that 38 per cent of the Australian population now own shares directly and 46 per cent indirectly or directly.²² These figures understate actual share ownership as they do not include shareholdings through superannuation funds, which hold around \$440 000 million in Australian equities and unit trusts.²³ The link between investment performance and retirement income, coupled with the spate of corporate collapses in 2001, fostered an expectation of protection amongst Australia's new shareholders and created a political need to respond as shareholders were also voters.²⁴ Shareholders again experienced the impact of market volatility on their investments when share prices declined in the wake of the US sub-prime mortgage crisis and related

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- 21 See Anthony Perkins and Michael Perkins, *The Internet Bubble* (1999), 197–208; Geert Lovink, 'After the Dotcom Crash' (2002) 8 (1) *Cultural Studies Review* 130; Duffy, above n 11, 436–7; Robert White, Bruce Tranter and Dallas Hanson, 'Share Ownership in Australia – The Emergence of New Tensions?' (2004) 40 (2) *Journal of Sociology* 99; and Gail Pearson, 'Risk and the Consumer in Australian Financial Services Reform' (2006) 28 *Sydney Law Review* 99.
- 22 ASX Limited, *2006 Australian Share Ownership Study* (2007) ASX Limited <http://www.asx.com.au/about/pdf/2006_austrian_share_ownership_study.pdf> at 6 September 2008. The figures are slightly down on the ASX's *2004 Australian Share Ownership Study*, which found that 55 per cent of Australians held shares directly or indirectly.
- 23 See Australian Bureau of Statistics, *Superannuation: Coverage and Financial Characteristics, Australia, Jun 2000* (2001) <<http://www.abs.gov.au/AUSSTATS/abs@.nsf/ProductsbyCatalogue/99726666BEFEA136CA256AC90080C009?OpenDocument>> at 6 September 2008, for the last comprehensive survey of the coverage of superannuation across the Australian population, relating to the period April to June 2000. At that time, a total of 13 388 800 people between the ages of 15 and 69 in Australia held superannuation accounts. This constituted approximately 70 per cent of the total population. Further, for the September quarter of 2007, superannuation funds holdings of Australian equities and units in trusts peaked at approximately 50 per cent of total superannuation assets (\$502 086 million out of total unconsolidated superannuation assets of \$1 009 605 million) before declining to 46 per cent of total superannuation assets (\$446 918 million of total unconsolidated superannuation assets of \$967 987 million) in the June quarter 2008: Australian Bureau of Statistics, *Managed Funds, Australia, June 2008* (2008) 11 <http://www.ausstats.abs.gov.au/ausstats/subscriber.nsf/0/ED5C856AA783BD87CA2574B9001629FD/S/56550_jun%202008.pdf> at 15 September 2008.
- 24 Prominent Australian corporate collapses included Pasmenco, Ansett, One Tel, Impulse Airlines, Harris Scarfe, and HIH Holdings. See Australian Broadcasting Corporation Television '2001: The Year of Corporate Collapses', *The 7.30 Report*, 20 December 2001 <www.abc.net.au/7.30/content/2001/s445523.htm> at 6 September 2008, referring to losses of \$13 billion. See also, John Coffee, 'Regulation-lite Belongs to a Different Age', *Financial Times* (London), 21 January 2008, 11, which explains that there is a stronger political demand for enforcement in the US than in the UK because the American middle class holds its retirement savings in the share market. The same reasoning may explain the political demand for enforcement in Australia.

‘credit crunch’.²⁵ Further, failed investment schemes have been felt by many Australian consumer–investors.²⁶

Consumerism changes the moral colouration of a share price fall or a corporate collapse because it brings new information, understanding and expectations.²⁷ The shareholder perceives an injury that previously may have been seen as a loss put down to bad luck or part of the risk of investing on the stock market. For example, Mr Margaretic, who brought a suit against Sons of Gwalia Limited, explained his successful action as ‘a moral victory’, which ‘puts trust into the whole system of buying and selling shares’.²⁸ Further, the perspective that someone must be responsible or to blame for a corporate collapse is illustrated by the almost constant complaints about ASIC not acting soon enough when a company or investment fund fails.²⁹ Less is said about investors needing to assess the risk of an investment or adopt a portfolio approach to investing their funds.³⁰

The creation of new causes of action in the *Corporations Act 2001* (Cth) (*‘Corporations Act’*) and *Australian Securities and Investments Commission Act 2001* (Cth) (*‘ASIC Act’*) based on misleading and deceptive conduct and the requirement of continuous disclosure have transformed shareholders’ views as to who is at fault. The legislation has created a new morality and a sense of entitlement.³¹ There are no innocent mistakes anymore because a legislative provision is now breached and fault can be attributed.

B Institutional Investors

The mandatory superannuation requirements and rise in share ownership in Australia has meant that institutional investors are important decision-makers in relation to many companies’ shares.³²

Institutional investors have not traditionally taken part in shareholder litigation, let alone class actions, for a number of reasons. These include the direct costs of paying legal fees and possibly the opponent’s costs if unsuccessful, and indirect costs such as management time, the impact on business

25 Share prices declined significantly in Australian companies and property trusts with exposure to sub-prime mortgages or high levels of debt, such as Centro Properties Group, Centro Retail Group, Allco Finance Group, ABC Learning Group, Babcock & Brown, Octaviar (formerly named MFS) and Rams Home Loans. See Ferguson, above n 2, 15; and Anne Lampe, ‘The Shifting Battleground’ (2008) 24 (2) *Company Director* 24, 26.

26 Commonwealth, *Official Committee Hansard*, Senate Standing Committee on Economics, 30 May 2007, 96 (Nick Sherry), referring to 19 000 investors losing almost \$1 billion.

27 See Felstiner, Abel and Sarat, above n 5, 641.

28 Andrew Trounson, ‘Historic Win for Duped Investors’, *The Australian* (Sydney), 1 February 2007.

29 John Collett, ‘Rise of the Vigilante’, *The Sydney Morning Herald* (Money) (Sydney), 2 May 2007, 10.

30 A portfolio approach means that it is not enough to look at the expected risk and return of one particular investment. Investors can reduce their exposure to individual asset risk by holding a diversified portfolio of assets. This is described colloquially as ‘not putting all of your eggs in one basket’. See, eg, Edna Carew, *The Language of Money* (3rd ed, 1996) 257.

31 See Felstiner, Abel and Sarat, above n 5, 643.

32 Ian Ramsay, G P Stapledon and Kenneth Fong, ‘Corporate Governance: The Perspective of Australian Institutional Shareholders’ (2000) 18 *Company and Securities Law Journal* 110, 111.

relationships, and the requirement to give discovery, which may not only result in further costs but also the potential disclosure of proprietary information about how investment decisions are made.³³

However, the factors that have transformed a share price fall or corporate collapse into shareholder litigation have also caused institutional investors to become group members in shareholder class actions.³⁴ Although consumerism focuses on empowering small shareholders, the causes of action that result are equally available to institutional investors such as banks, hedge funds and insurance companies. Class actions and litigation funding are available to institutional investors as much, or perhaps even more so, than individual shareholders, as discussed in Part VII of this article. The litigation funder can substantially reduce the risk of pursuing litigation through organising a representative party to commence the class action so that the institutional investor can take a more anonymous role and avoid costs. As such, the disincentives that faced institutions have been significantly reduced.

Nonetheless, participation in a class action by an institution still requires consideration of a number of factors, such as fiduciary obligations, prospects of success, likely recovery, and direct and indirect costs. Further, the institutional investor who retains an investment in a going concern entity on which they have lost money has a dual role as investor and shareholder. Resources used to defend a class action or to fund a settlement or adverse verdict reduce the resources within the entity that could be directed towards dividends or investments that increase the share price. The institutional investor may effectively fund its own pay-out from the litigation.³⁵ Participation in a class action is still not a foregone conclusion for institutional investors, but it is now far more likely.

III MISLEADING AND DECEPTIVE CONDUCT

A Background

The provisions prohibiting misleading and deceptive conduct in the securities area are based upon section 52 of the *Trade Practices Act 1974* (Cth) ('TPA'),

33 Michael Legg, 'Institutional Investors and Shareholder Class Actions: The Law and Economics of Participation' (2007) 81 *Australian Law Journal* 478, 481; and Lynden Griggs, 'Institutional Investors and Corporate Governance' (1996) 3 *James Cook University Law Review* 44, 54.

34 See Erica Vowles (ed), *Across the Board News* (14 March 2006) 5
<<http://ww5.cch.com.au/dpen/dpen170.html>> at 6 September 2008, reporting that the Chairman of Maurice Blackburn Cashman, Mr Bernard Murphy, stated that:

I recall back in 1998 when [King v] GIO started, going around Sydney and seeing which of the institutions would join that case. Now, we had 22,000 clients but very few of the institutions joined in. In 2003 when I was starting the Aristocrat class action, the interest level from institutions was significantly greater and of that claim value which is \$120 million, 94% comes from the institutions.

See also, Mathew Dunckley, 'Bid to Separate Centro Actions', *The Australian Financial Review* (Sydney), 25 August 2008, 57.

35 Legg, above n 33, 482.

which has been variously described as the plaintiff's exocet,³⁶ a statutory comet,³⁷ and 'one of the most heavily litigated statutory provisions in Australian law'.³⁸ The early cases recognised section 52 as being 'expressed in wide terms',³⁹ 'a comprehensive provision of wide impact',⁴⁰ and 'being of a remedial character so that it should be construed so as to give the fullest relief which the fair meaning of its language will allow'.⁴¹

All of the above statements demonstrate that the adoption of a standard of commercial morality in legislation that has few requirements and provides substantial remedies such as damages and injunctions will be frequently used. This broad-based remedy has now been applied to securities and can be expected to have similar far-reaching effects as is explained below.

The *TPA* was extended to securities through judicial decisions, until securities specific legislation was enacted in 1998.⁴² The misleading and deceptive conduct prohibition in relation to securities is now embodied in sections 670A, 728 and 1041H of the *Corporations Act 2001* (Cth) ('*Corporations Act*'), and section 12DA of the *Australian Securities and Investments Commission Act 2001* (Cth) ('*ASIC Act*'). However, the extensive case law on section 52, and section 82, which provides the regime for compensation, remain applicable.⁴³

B Statutory Causes of Action

Section 1041H of the *Corporations Act* prohibits persons from engaging in conduct in relation to a financial product or a financial service that is misleading or deceptive.⁴⁴ Section 12DA of the *ASIC Act* is framed in similar terms to

36 Warren Pengilly, 'Section 52 of the *Trade Practices Act*: A Plaintiff's New Exocet' (1987) 15 *Australian Business Law Review* 247. The exocet reference comes from the Falklands war where Argentinian warplanes used exocet missiles to sink the Royal Navy's HMS Sheffield.

37 See The Hon Mr Justice R S French, 'A Lawyers Guide to Misleading or Deceptive Conduct' (1989) 63 *Australian Law Journal* 250, 250:

Resorting to florid metaphor, the dedicated legal modernist may depict the common law and its causes of action as primeval broadacres grazed by slow-growing sauropods. Upon this landscape the action for misleading or deceptive conduct falls as a kind of statutory comet threatening significant reductions in the species numbers of fraud, negligent misstatement, passing off, defamation, contractual warranty and contractual representation.

38 Allan Asher, 'A "Theory of Everything" for Consumer Protection?' (2006) 14 *Trade Practices Law Journal* 110, 110.

39 *Hornsby Building Information Centre Pty Ltd v Sydney Building Information Centre Ltd* (1977) 140 CLR 216, 223.

40 *Brown v Jam Factory Pty Ltd* (1981) 53 FLR 340, 348.

41 *Accounting Systems 2000 (Developments) Pty Ltd v CCH Australia Ltd* (1993) 42 FCR 470, 503.

42 For example, section 52 was applied to securities in *Poseidon Ltd v Adelaide Petroleum NL* (1991) 105 ALR 25 (representations made during the course of a takeover) and *Fraser v NRMA Holdings Ltd* (1995) 55 FCR 452 (prospectus). The *Trade Practices Act* ceased to apply to financial services after 1 July 1998 when the *ASIC Act* s 12DA and other provisions mirroring the *Trade Practices Act* were enacted. See *Trade Practices Act* s 51AF(2)(a). See also, *Houghton v Arms* (2006) 225 CLR 553; *Rawley Pty Ltd v Bell (No 2)* (2007) 61 ACSR 648, [33].

43 See *National Exchange Pty Ltd v ASIC* (2004) 49 ACSR 369, [18]; and *Rawley Pty Ltd v Bell (No 2)* (2007) 61 ACSR 648, [37].

44 *Corporations Act* s 1041H(1) provides: 'A person must not, in this jurisdiction, engage in conduct, in relation to a financial product or a financial service, that is misleading or deceptive or is likely to mislead or deceive.'

section 1041H, but only relates to ‘financial services’.⁴⁵ Both are applicable to securities, including shares.⁴⁶ Section 1041I of the *Corporations Act* and section 12GF(1) of the *ASIC Act* provide that a person who suffers loss or damage by conduct in contravention of section 1041H or section 12DA respectively, may recover the amount of loss or damage by action against the person contravening the section or against any person involved in the contravention (accessorial liability).

The scope of the general provisions – section 1041H of the *Corporations Act* and section 12DA of the *ASIC Act* – is very broad, but conduct that contravenes a specific provision against misleading and deceptive statements in takeover documents (section 670A of the *Corporations Act*) or a fundraising document (*Corporations Act* section 728), is excluded from the general provisions.⁴⁷

Section 728(1) of the *Corporations Act* forms part of Chapter 6D, which deals with fundraising, and provides that a person is prohibited from offering securities under a disclosure document where there is a misleading or deceptive statement in the disclosure document, any application form accompanying the disclosure document, or any document that contains the offer if the offer is not in the disclosure document or the application form. Disclosure documents include prospectuses, short form prospectuses, ‘transaction specific’ prospectuses, profile statements and offer information statements.⁴⁸

Section 729 of the *Corporations Act* provides a right of compensation in similar terms to section 1041I – that is, a person who suffers loss or damage because an offer of securities under a disclosure document contravenes section 728(1) may recover the amount of the loss or damage from a list of specified persons. These include the person making the offer, directors, proposed directors, underwriters, persons making statements in the disclosure statement, and a person who contravenes, or is involved in the contravention of, section 728(1).⁴⁹ However, unlike section 1041H, a number of defences are available. These include reasonable reliance on information given by someone else, withdrawal of consent, reasonable inquiries and reasonable belief (that is, due diligence), and lack of knowledge.⁵⁰

Section 670A contains a prohibition on giving various takeover documents if there is a misleading or deceptive statement in the document. The documents include the bidder’s statement, target’s statement, compulsory acquisition and compulsory buy-out notices and experts’ reports. Section 670B provides that a person who suffers loss or damage that results from a contravention of section

45 *ASIC Act* s 12DA provides: ‘A person must not, in trade or commerce, engage in conduct in relation to financial services that is misleading or deceptive or is likely to mislead or deceive.’

46 See *Corporations Act* s 764A(1), *ASIC Act* ss 12BAA and 12BAB; *ASIC v Narain* (2008) 66 ACSR 688, [1], [40]; *ASIC v National Exchange Pty Ltd* (2003) 47 ACSR 128, [2]; and *Singh v Singh* [2004] NSWSC 850 (Unreported, McLaughlin M, 14 September 2004) [50].

47 *Corporations Act* s 1041H(3) and *ASIC Act* s 12DA (1A).

48 See *Corporations Act* Pt 6D.2 Div 3.

49 *Corporations Act* s 729(1).

50 *Corporations Act* ss 731, 732 and 733.

670A may recover the amount of the loss or damage from a list of specified persons. These include the bidder, a director of a bidder, the target, a director of the target, persons making statements in the documents and a person who contravenes, or is involved in the contravention of, section 670A. A number of defences are available, namely, the person did not know that the statement was misleading or deceptive, the person did not know that there was an omission, reasonable reliance on information given by someone else, and withdrawal of consent.⁵¹

Shareholders may also still plead section 52 of the *TPA*, despite it no longer applying to financial services, so as to cover the rare situation where the allegedly misleading or deceptive conduct does not relate to a financial service, financial product, fundraising or takeover document.

For completeness, it should be noted that Part 7 of the *Corporations Act* also contains prohibitions on misleading or deceptive conduct. Part 7.7 of the *Corporations Act* deals with financial services disclosure and the two key methods of disclosure, a financial services guide and a statement of advice.⁵² Part 7.9 of the *Corporations Act* deals with financial product disclosure and product disclosure statements.⁵³ The *Corporations Act* defines a defective financial services guide or statement of advice or product disclosure statement as including ‘a misleading or deceptive statement’ and provides for the recovery of loss or damage.⁵⁴ The provisions do not typically apply to shareholder suits as they govern the role of intermediaries such as advisers and brokers, and the issuers of financial products such as insurance and superannuation.⁵⁵

C Ease of Proof of Statutory Causes of Action

The statutory causes of action for misleading or deceptive conduct transform losses from investing in shares into litigation by providing a cause of action that suggests someone is to blame and by improving a shareholder’s prospects of success because:

- The conduct will usually be directed to an unidentified group of people so that a representative member of that group must be determined by the court to ascertain if the conduct is misleading or deceptive.⁵⁶ The ordinary or reasonable representative of that group may be an

51 *Corporations Act* s 670D.

52 See *Corporations Act* ss 941A, 941B and 946A, for when a financial services guide or a statement of advice are required. See also, PSB Hutley and PA Russell, *An Introduction to the Financial Services Reform Act 2001* (3rd ed 2005) ch 4; and ASIC, *Regulatory Guide 168 – Disclosure: Product Disclosure Statements* (May 2005) 26–30.

53 For when a product disclosure statement is required see *Corporations Act* ss 1012A, 1012B and 1012C. See also Hutley and Russell, above n 52, ch 4; and ASIC, above n 52, 26–30.

54 *Corporations Act* ss 953A(1)(a)(i), 953A(1)(b)(i), 953B(2)(b), 1022A(1)(a) and 1022B(2)(c).

55 Dimity Kingsford Smith, ‘Is “Due Diligence” Dead? Financial Services and Products Disclosure Under the *Corporations Act*’ (2004) 22 *Companies and Securities Law Journal* 128, 134–5.

56 *Campomar Sociedad, Limitada v Nike International Ltd* (2000) 202 CLR 45, 85: followed in *National Exchange Pty Ltd v Australian Securities and Investments Commission* (2004) 49 ACSR 369, [18]–[19] in relation to s 1041H(1).

unsophisticated retail level investor or a person without experience in dealing with shares, which increases the likelihood that they may be misled.⁵⁷

- The connection between a misleading statement and a share so as to attract the operation of section 1041H of the *Corporations Act* and section 12DA of the *ASIC Act* can be indirect or less than substantial.⁵⁸
- Silence may amount to misleading or deceptive conduct where the context requires disclosure to avoid a person being misled or deceived.⁵⁹ In the securities context, the continuous disclosure regime (discussed below) will frequently create the need to disclose.⁶⁰
- Forecasts and forward-looking statements, a staple of takeovers and initial public offerings, are subject to the misleading or deceptive conduct regime.⁶¹ The *Corporations Act* and *ASIC Act* provide that a person is taken to make a misleading statement about a future matter if they do not have reasonable grounds for making the statement.⁶² However, the *ASIC Act* reverses the onus of proof in relation to reasonableness by stating that the person is taken not to have had reasonable grounds unless they adduce evidence to the contrary.⁶³
- Intention is irrelevant. The provisions are drafted so as to be concerned with consequences and not the contravener's state of mind.⁶⁴ It is therefore incorrect to refer to the provisions as addressing securities 'fraud' as there is no requirement of fraudulent conduct.

57 *Fraser v NRMA Holdings Ltd* (1995) 55 FCR 452, 467; *Downey v Carlson Hotels Asia Pacific Pty Ltd* [2005] QCA 199 (Unreported, Queensland Court of Appeal, Williams and Keane JJA, Atkinson J, 10 June 2005) [65].

58 *Australian Securities and Investments Commission v Narain* (2008) 66 ACSR 688, [9], [76].

59 See *Demagogue Pty Ltd v Ramensky* (1992) 39 FCR 31; *Rhone-Poulenc Agrochimie SA v UIM Chemical Services Pty Ltd* (1986) 12 FCR 477, 490, 504 and 508; and *Henjo Investments Pty Ltd v Collins Marrickville Pty Ltd* (1988) 39 FCR 546, 557 (Lockhart J): 'silence may be relied on in order to show a breach of s 52 when the circumstances give rise to an obligation to disclose relevant facts'.

60 *GPG (Australia Trading) Pty Ltd v GIO Australia Holdings Ltd* (2001) 117 FCR 23, 70.

61 See, eg. *Australian Securities and Investments Commission v PFS Business Development Group Pty Ltd* (2006) 57 ACSR 553, [365], [369]; and *Downey v Carlson Hotels Asia Pacific Pty Ltd* [2005] QCA 199 (Unreported, Queensland Court of Appeal, Williams and Keane JJA, Atkinson J, 10 June 2005) [124].

62 *Corporations Act* ss 670A(2), 728(2) and *ASIC Act* s 12BB(1).

63 *ASIC Act* s 12BB(2).

64 *Hornsby Building Information Centre Pty Ltd v Sydney Building Information Centre Ltd* (1978) 140 CLR 216, 228, (Stephen J): 'As I read s 52(1) ... it is concerned with consequences as giving to particular conduct a particular colour. If the consequence is deception, that suffices to make the conduct deceptive'; *Brown v Jam Factory Pty Ltd* (1981) 53 FLR 340, 348; *Australian Securities and Investments Commission v Online Investors Advantage Inc* [2005] QSC 324 (Unreported, Supreme Court of Queensland, Moynihan J, 26 October 2005) [138] dealing with section 1041H(1) of the *Corporations Act* and section 12DA(1) of the *ASIC Act*.

- Liability may be extended to accessories thus increasing the funds available to contribute to a settlement or satisfy a judgment.⁶⁵
- Monetary compensation is an available remedy.

The ease of proof of the misleading and deceptive cause of action has been widely acknowledged. The High Court has recognised that although section 52 ‘provides the public with wider protection from deception than the common law, it does not follow that there is a conflict between the section and the common law. The statute provides an additional remedy’.⁶⁶ This is equally applicable to the *Corporations Act* and *ASIC Act* causes of action. Indeed, the High Court in *Sons of Gwalia Ltd v Margaretic* observed that it was more likely that a shareholder would rely on the statutory causes of action than the tort of deceit.⁶⁷ The statutory causes of action are easier to prove than common law causes of action. For example, actions in tort for negligent or fraudulent misrepresentation contain additional hurdles to be overcome when compared with the statutory causes of action based on misleading and deceptive conduct.⁶⁸ Even negligent misrepresentation, which was thought to give rise to a major expansion of the law when it was recognised by the House of Lords in *Hedley Byrne & Co Ltd v Heller & Partners Ltd*⁶⁹ requires a degree of culpability – namely negligence – that the statutory causes of action are free from, and is limited in scope by the need for the existence of a duty of care.⁷⁰

Despite the substantial advantages provided to shareholders in bringing a suit pursuant to the statutory misleading and deceptive conduct prohibitions, each of the elements of the statutory cause of action must still be made out. The improvement in a shareholder’s prospects of success faces two main constraints: the requirement of causation and the defences to the causes of action based on misleading or deceptive statements in fundraising or takeover documents.

65 *Corporations Act* s 1041I(1), 670B(1) item 11, 729(1) item 6 and *ASIC Act* s 12GF(1). All are modelled on the *Trade Practices Act* s 82. See also *Corporations Act* s 79 which is modelled on the *Trade Practices Act* s 75B. The *ASIC Act* s 5(3) makes *Corporations Act* s 79 applicable to the *ASIC Act*.

66 *Parkdale Custom Built Furniture Pty Ltd v Puxu Pty Ltd* (1982) 149 CLR 191, 205 (Mason J), quoted with approval in *Campomar Sociedad Limitada v Nike International Ltd* (2000) 202 CLR 45, 83 (Gleeson CJ, Gaudron, McHugh, Gummow, Kirby, Hayne and Callinan JJ).

67 *Sons of Gwalia Ltd v Margaretic* (2007) 231 CLR 160, 214 (Hayne J).

68 See Pengilly, above n 36, 259–60; and The Hon Mr Justice R S French, above n 37, 250.

69 *Hedley Byrne & Co Ltd v Heller & Partners Ltd* [1964] AC 465. See also *Mutual Life & Citizens’ Assurance Co Ltd v Evatt* (1968) 122 CLR 556; and *San Sebastian Pty Ltd v Minister Administering the Environmental Planning and Assessment Act 1979* (1986) 162 CLR 340.

70 Peter Gillies, ‘Actions for Breach of s 52 and for Negligent Misstatement at Common Law – Some Observations on their Relative Competitiveness’ (2003) 11 *Competition and Consumer Law Journal* 1; Mylton Burns, ‘Has s 52 of the TPA Rendered Negligent Misstatement Irrelevant to Australian Professional Indemnity Insurance for “Advice” Professionals’ (2001) 12 *Insurance Law Journal* 1.

1 Causation

Despite the broad nature of the securities law prohibitions on misleading or deceptive conduct, causation must still be proved.⁷¹ Under section 52 of the *TPA*, an applicant must show that he or she has been induced by misleading or deceptive conduct to do something or to refrain from doing something which gives rise to damage.⁷² The burden is therefore on the claimant to satisfy the court that he or she relied upon the allegedly misleading or deceptive conduct.⁷³

However, it is sufficient to prove that the misleading or deceptive conduct was but one of a number of causes of the damage.⁷⁴ The law acknowledges that people are often swayed by several considerations. It attributes causality to a single one of those considerations if it makes a material contribution or has had a substantial rather than a negligible effect.⁷⁵ If a case goes to trial, even as a class action, each shareholder must demonstrate that they relied on the conduct and the conduct caused loss.⁷⁶ Failure to prove causation will mean that a shareholder's claim will fail.⁷⁷

Class action promoters are seeking to overcome the causation requirements through the fraud on the market theory and a statutory construction of the *Corporations Act* and *ASIC Act* that does not require reliance by the entity that suffers loss as a prerequisite to recovery.⁷⁸

71 *Corporations Act* s 1041I(1) and *ASIC Act* s 12GF(1) use the expression 'by' which the High Court in *Wardley Australia Ltd v Western Australia* (1992) 175 CLR 514, 525, interpreted as expressing the notion of causation. The use of 'because' in section 729 and the use of 'results from' in section 670B also connote causation. See *Wardley Australia Ltd v Western Australia* (1992) 175 CLR 514, 525, (in relation to legislative wording that establishes causation, '[o]ne might have expected ... "as a result of".'); *Purvis v Department of Education & Training (NSW)* (2003) 217 CLR 92, 162–3; and *Trust Company of Australia Ltd v Commissioner of State Revenue* (2006) 62 ATR 258, [40] ('because of' is an expression of causation).

72 *Kabwand Pty Ltd v National Australia Bank Ltd* (1989) ATPR 40–950, 50 378; *Argy v Blunts & Lane Cove Real Estate Pty Ltd* (1990) 26 FCR 112, 138.

73 *Butcher v Lachlan Elder Realty Pty Ltd* (2004) 218 CLR 592, 604; 'if a person is so determined to enter into a contract that he is not in truth influenced by some false representation made to him, he clearly has no case': *Sutton v A J Thompson Pty Ltd (in liq)* (1987) 73 ALR 233, 240.

74 *I & L Securities Pty Ltd v HTW Valuers (Brisbane) Pty Ltd* (2002) 210 CLR 109, 128 (Gaudron, Gummow and Hayne JJ): 'it is now well established that the question presented by s 82 of the Act is not what was the (sole) cause of the loss or damage which has allegedly been sustained. It is enough to demonstrate that contravention of a relevant provision of the Act was a cause of the loss or damage sustained' (emphasis in original).

75 *Henville v Walker* (2001) 206 CLR 459, 481, 495.

76 See *Guglielmin v Trescowthick (No 2)* (2005) 220 ALR 515, where the judge observed that each shareholder's claim in a class action involved different considerations of reliance and loss necessitating the determination of whether each person did in fact rely upon some or all of the communications pleaded to their detriment. See also, *Johnston v McGrath* [2007] NSWCA 231 (Unreported, Giles JA, Young CJ in Eq, Handley AJA, 4 September 2007) [28].

77 See *Johnston v McGrath* (2005) 195 FLR 101, 108.

78 See Michael Legg and Ron Schaffer, 'Sons of Gwalia Ltd v Margaretic – Encouraging Shareholder Claims and the Fraud on the Market Theory' (2007) 35 *Australian Business Law Review* 390, 394, 397, referring to the Ion administration and Aristocrat class action; and Corporations and Markets Advisory Committee, 'Shareholder Claims Against Insolvent Companies: Implications of the Sons of Gwalia Decision' (Discussion Paper, Corporations and Markets Advisory Committee, Australian Government, 2007), 81–3.

The fraud on the market theory is a United States legal application of the efficient market hypothesis and assumes that the price of shares in an open and developed market reflects all publicly available material information about those shares, including misleading statements or omissions.⁷⁹ The theory presumes that shareholders rely on the integrity of the market price in making their investment decisions such that a misleading statement or omission affects all shareholders through the share price, meaning that individual reliance does not need to be proved.⁸⁰ Fraud on the market theory is in essence a shortcut for causation. The various requirements to be able to rely on the presumption and rebut the presumption have been discussed elsewhere.⁸¹ The significance of Australian courts adopting the fraud on the market theory or some variation of it is that the main limitation on the ease of proving the various causes of action discussed above is removed.

Equally, class action promoters may rely on the purpose of the legislation to argue for a statutory construction of the *Corporations Act* and *ASIC Act* that replaces individual reliance with third party or indirect reliance.⁸² This argument extends the existing case law on section 52 of the *TPA*, which has found causation to be satisfied when customers have been misled by a trader so that they purchase more of that trader's product and less of a rival trader's product, so that the rival, although not misled, suffers loss or damage as a result of the customers' reliance.⁸³ In the shareholder class action context, the share market will be argued to be analogous to the customers. As for the fraud on the market theory, causation becomes easier to prove as individual shareholders do not need to demonstrate that they relied on a misrepresentation or omission. Rather, they must demonstrate that the market relied upon it, which will be presumed if the market is efficient. The counter-argument is that third party reliance is only sufficient to satisfy causation where the entity that suffers loss or damage does so without the need to do anything else – that is, no conduct on the part of that

79 *Basic Inc v Levinson* 485 US 224 (1988), 241–2. The Efficient Markets Hypothesis is generally traced back to a 1970 academic article: Eugene Fama, 'Efficient Capital Markets: A Review of Theory and Empirical Work' (1970) 25 *Journal of Finance* 383. See generally Michael Duffy, 'Fraud on the Market: Judicial Approaches to Causation and Loss from Securities Nondisclosure in the United States, Canada and Australia' (2005) 29 *Melbourne University Law Review* 621; and Weng Siow, 'Fraud-on-the-Market in Australia?' (2007) 23 *Butterworths Corporations Law Bulletin* [798].

80 Daniel R Fischel, 'Efficient Capital Markets, the Crash, and the Fraud on the Market Theory' (1989) 74 *Cornell Law Review* 907, 908; Frederick Dunbar and Arun Sen, 'Shareholder Class Actions and the Counterfactual' (Working Paper, NERA Economic Consulting, 2008) 11–12 <http://www.nera.com/publication.asp?p_ID=3518> at 6 September 2008.

81 See Legg and Schaffer, above n 78, 395.

82 See, eg, *Allianz Australia Insurance Ltd v GSF Australia Pty Ltd* (2005) 221 CLR 568, 587: 'the question of causation is determined in light of the subject, scope and objects of the Act.' (McHugh J); and 597: 'notions of "cause" as involved in a particular statutory regime are to be understood by reference to the statutory subject, scope and purpose.' (Gummow, Hayne and Heydon JJ).

83 Transcript of Proceedings, *Dorajay Pty Ltd v Aristocrat Leisure Limited* (Federal Court of Australia, 29 October 2007), 497–503; *Janssen-Cilag Pty Ltd v Pfizer Pty Ltd* (1992) 37 FCR 526; *Finishing Services Pty Ltd v Lactos Fresh Pty Ltd* [2006] FCAFC 177 (Unreported, Kiefel, Sundberg and Edmonds JJ, 30 October 2006, 7 December 2006) [31].

entity forms part of the causal chain. In contrast, if the allegation is that loss or damage is suffered because a transaction was entered into as a result of a misrepresentation, then the entity must prove reliance on that misrepresentation.⁸⁴

The above arguments were fully briefed in the Aristocrat class action, but as the proceedings were settled after trial, no judgment was delivered. However, the arguments are likely to be revisited in the Multiplex and Centro class actions as a form of third party or indirect reliance via the market is pleaded.

2 Defences

The Australian legislative regime seeks to carve out a more measured approach to liability for the specific causes of action, most notably by providing for certain defences. The legislation attempts to achieve this by immunising conduct that contravenes sections 670A and 728 of the *Corporations Act* from the strict liability of section 1041H and section 12DA of the *ASIC Act*. This demarcation was first introduced to reflect the different philosophies of consumer protection that applied in relation to section 52 of the *TPA* and investor protection that applied to fundraising, but which had been lost when section 52 was extended to securities.⁸⁵ The defences are an acknowledgment that investments provide a return to investors based on them bearing a share of the risks which are intrinsic to financial activity, particularly due to imperfect information. Consequently, Treasury proposed that liability rules should not shift to fundraisers the investment risk properly accepted by investors in efficient securities markets.⁸⁶

The defences are said to make the prosecution of those claims more difficult.⁸⁷ This should be the case based on the different policy underpinnings. However, the immunity may not apply if the conduct does not fall within the terms of sections 670A or 728 of the *Corporations Act* – that is, the conduct does not relate to one of the specified types of documents referred to in those provisions. For example, in the course of fundraising activity, a company may issue a document for the purpose of advertising or for a briefing of analysts, or the issue of a supplementary prospectus, or the issue of an announcement to ASX. On other occasions, the company may offer securities in circumstances where there is no legal requirement to lodge a disclosure document with ASIC (for example, a large private placement to institutions), but nevertheless it issues an information

84 Transcript of Proceedings, *Dorajay Pty Ltd v Aristocrat Leisure Limited* (Federal Court of Australia, 29 October 2007), 543–51; *Digi-Tech (Australia) Ltd v Brand* (2004) 62 IPR 184, [158]–[159]; *Ingot Capital Investments Pty Ltd v Macquarie Equity Capital Markets Ltd (No 6)* (2007) 63 ACSR 1 at [493]–[510].

85 *Fraser v NRMA Holdings Ltd* (1995) 55 FCR 452; Michael Legg, ‘Misleading and Deceptive Conduct in Prospectuses’ (1996) 14(1) *Company and Securities Law Journal* 47.

86 Corporate Law Economic Reform Program, ‘Fundraising – Capital Raising Initiatives to Build Enterprise and Employment’ (1997) Australian Government: The Treasury, 41 <<http://www.treasury.gov.au/documents/282/HTML/docshell.asp?URL=default.asp>> at 18 September 2008.

87 Duffy, above n 11, 449.

memorandum.⁸⁸ In these situations the immunity does not apply and the company is exposed to liability under section 1041H(1) or section 12DA in respect of its conduct. Equally in the takeovers context, section 670A only relates to the formal bid documents (bidder's statement, takeover offer, notice of variation, target's statement, compulsory acquisition notice, or any report accompanying any of these documents) leaving section 1041H and section 12DA to govern any other document or conduct connected with a takeover bid.⁸⁹

IV CONTINUOUS DISCLOSURE

A Background

Continuous disclosure is based on the efficient market hypothesis that share prices fully reflect all available information and that requiring mandatory disclosure of price-sensitive information, that may otherwise remain private, promotes the accuracy of share prices.⁹⁰ The main aim of continuous disclosure is to enhance confident and informed participation by investors in secondary securities markets.⁹¹ Continuous disclosure is also fundamental to corporate governance and investor protection through preventing insider trading and market manipulation.⁹²

Historically, continuous disclosure was mandated and enforced by stock exchange listing rules. Generally, the listing rules required the immediate disclosure of any information likely to materially affect the price of a corporation's securities.⁹³ Failure to comply was policed by the stock exchange which could make inquiries, issue press releases, suspend or delist companies.⁹⁴

The ASX Listing Rules today contain several provisions addressing when listed bodies must make immediate disclosure of information to the market.⁹⁵

88 See Robert P Austin and Ian M Ramsay, *Ford's Principles of Corporations Law* (LexisNexis 2005 online), [22.450]; and CCH Australian Corporations Commentary (CCH 2008 online) [202]–[320].

89 Austin and Ramsay, above n 88 [23.640]; Ian Renard and Joseph Santamaria, *Takeovers and Reconstructions in Australia* (LexisNexis 2005 online) [927].

90 See Entcho Raykovski, 'Continuous Disclosure: Has Regulation Enhanced the Australian Securities Market?' (2004) 30 *Monash University Law Review* 269, 270–278 and Angie Zandstra, Jason Harris and Anil Hargovan, 'Widening the Net: Accessorial Liability for Continuous Disclosure Contraventions' (2008) 22 *Australian Journal of Corporate Law* 51, 54–5, explaining the theoretical basis of continuous disclosure.

91 Companies and Securities Advisory Committee, *Report on an Enhanced Statutory Disclosure System* (1991) 6–7; and Corporate Law Economic Reform Program, *Corporate Disclosure: Strengthening the Financial Reporting Framework* (Paper No 9, 2002) 129.

92 Corporate Law Economic Reform Program, above n 91, 129; Belinda Gibson, 'Improving Confidence and Integrity in Australia's Capital Markets' (Paper presented to the Committee for Economic Development of Australia (CEDA), Sydney, 8 July 2008) 2
<[http://www.asic.gov.au/asic/pdf/lib.nsf/LookupByFileName/Integrity_capital_markets_Gibson_July_2008.pdf/\\$file/Integrity_capital_markets_Gibson_July_2008.pdf](http://www.asic.gov.au/asic/pdf/lib.nsf/LookupByFileName/Integrity_capital_markets_Gibson_July_2008.pdf/$file/Integrity_capital_markets_Gibson_July_2008.pdf)> at 8 September 2008.

93 Companies and Securities Advisory Committee, above n 91, 4; House of Representatives Standing Committee on Legal and Constitutional Affairs, Parliament of the Commonwealth of Australia, *Corporate Practices and the Rights of Shareholders* (1991) 92.

94 House of Representatives Standing Committee on Legal and Constitutional Affairs, above n 93, 30.

95 ASX Listing Rules 3.1, 3.1A and 3.1B.

The tools for enforcement are largely the same, but the *Corporations Act* provides for the ASX to be able to institute proceedings to enforce compliance with the rules.⁹⁶

In 1994, the statutory requirement for continuous disclosure was enacted.⁹⁷ The statutory requirements are now in Chapter 6CA of the *Corporations Act*, which gives the ASX Listing Rules legislative backing. Chapter 6CA requires disclosing entities to notify the ASX of information required to be disclosed by the Listing Rules where that information is not generally available and is information that a reasonable person would expect, if it were generally available, to have a material effect on the price or value of ED securities of the entity.⁹⁸ The entity and any person involved in the entity's contravention may be held liable.⁹⁹ A due diligence defence is available for individuals.¹⁰⁰

Although the continuous disclosure requirements can be succinctly stated, their application in practice can be very difficult leading to uncertainty which makes a breach more likely.¹⁰¹ Directors must tread the fine line between timely disclosure, premature disclosure that may create a false market, and late disclosure that leaves the market uninformed.

B A Private Cause of Action for Compensation

An entity that does not disclose accurately and when required may be subject to enforcement action by ASIC. However, of significance here is that the legislature has also provided for private causes of action. The substantive sections described above are financial services civil penalty provisions.¹⁰² Any person who suffers damage in relation to a contravention of a financial services civil penalty provision may apply for a compensation order.¹⁰³ A court may order a person (the liable person) to compensate another person (including a corporation) for damage suffered by the person if: (a) the liable person has contravened a financial services civil penalty provision; and (b) the damage resulted from the contravention.¹⁰⁴ Originally, a claim for damages required proof of negligence.¹⁰⁵ Pursuant to that standard, the first example of civil damages for a failure to disclose took place in 2006.¹⁰⁶ However, since the

96 Josephine Coffey, 'Enforcement of Continuous Disclosure in the Australian Stock Market' (2007) 20 *Australian Journal of Corporate Law* 301, 313–14.

97 *Corporate Law Reform Act 1994* (Cth).

98 *Corporations Act* s 674 deals with listed disclosing entities and s 675 deals with other disclosing entities. When information is generally available is defined in s 676 and the material effect on price or value is defined in s 677.

99 *Corporations Act* ss 674(2A) and 675(2A).

100 *Corporations Act* ss 674(2B) and 675(2B).

101 See ASX Guidance Note 8 (June 2005) [11]; and *Riley v Jubilee Mines NL* (2006) 59 ACSR 252, [7].

102 *Corporations Act* ss 1317DA, 1317E.

103 *Corporations Act* s 1317J(3A).

104 *Corporations Act* s 1317HA(1).

105 See *Corporations Law 2001* (Cth) s 1005; and *Riley v Jubilee Mines NL* (2006) 59 ACSR 252.

106 Coffey, above n 96, 311 citing *Riley v Jubilee Mines NL* (2006) 59 ACSR 252.

Financial Services Reform Act 2001 (Cth), which took effect from 11 March 2002, intent or fault has been irrelevant.¹⁰⁷

Alternatively, a person may seek damages pursuant to section 1324(10) when an injunction is sought in relation to a contravention of the *Corporations Act* or compensation is sought pursuant to section 1325 for a contravention of Chapter 6CA of the *Corporations Act*. ASIC also has the option of using the infringement notice regime in Part 9.4AA of the *Corporations Act* to police less serious breaches of the requirements for continuous disclosure. In that situation, compensation orders may still be sought by a person who has suffered adverse consequences as a result of the entity's contravention of the continuous disclosure requirements.¹⁰⁸

These new causes of action still require proof of causation. The words 'resulted from' in particular have been held to connote causation.¹⁰⁹ Thus, the preceding discussion about class action promoters seeking to overcome strict causation requirements through the fraud on the market theory or statutory construction is equally applicable here.

Disclosures that are inaccurate, or a failure to disclose when obligated to (that is, silence), may also provide key evidence of misleading and deceptive conduct for the purposes of section 1041H of the *Corporations Act* and section 12DA of the *ASIC Act*. The continuous disclosure regime provides assistance to potential applicants and their lawyers by requiring disclosure of representations relating to key matters upon which investment decisions may be based such as financial information.¹¹⁰ In contrast, the *TPA* provisions on which section 1041H and section 12DA are based do not affirmatively require disclosure, so that they are only activated if an entity decides to speak.¹¹¹ Shareholders will receive regular representations, any one of which, if containing a misleading statement or omission, will ground the commencement of a class action based upon the statutory causes of action prohibiting misleading and deceptive conduct.¹¹²

107 See Revised Explanatory Memorandum, *Financial Services Reform Act 2001* (Cth) [18.3]; and *ASIC v Chemeq* (2006) 58 ACSR 169, [46].

108 *Corporations Act* s 1317DAF(6).

109 *Adler v ASIC* (2003) 179 FLR 1, 156.

110 Corporate Law Economic Reform Program, *Corporate Disclosure: Strengthening the Financial Reporting Framework* (Paper No 9, 2002) 129: 'The existence of a mandatory continuous disclosure regime recognises that entities will not always have incentives to voluntarily disclose price sensitive information to investors. This is most relevant in relation to information that may have adverse implications for the price of an entity's securities'.

111 *Fraser v NRMA Holdings Ltd* (1995) 55 FCR 452, 467 (Black CJ, von Doussa and Cooper JJ):

Whilst s 52 does not by its terms impose an independent duty of disclosure which would require a corporation or its directors to give any particular information to members ... , where information ... is promulgated, unless the information given constitutes a full and fair disclosure of all facts which are material to enable the members to make a properly informed decision, the combination of what is said and what is left unsaid may, depending on the full circumstances, be likely to mislead or deceive the membership.

112 Michael Legg and Dean Jordan, 'Disclosure Needs Special Care', *The Australian Financial Review* (Sydney), 14 February 2007, 55. See also, Andrew Cassidy and Larelle Chapple, 'Australia's Corporate Disclosure Regime: Lessons from the US model' (2003) 15 *Australian Journal of Corporate Law* 1, 5–6.

Since at least 1994, non-disclosure and inaccurate disclosure to the market have been considered wrongs that allow for the attribution of blame. The availability of damages through civil litigation since the late 1990s, combined with the removal of any need to show fault or intent since 2002, have facilitated claims.

V REGULATOR ASSISTANCE FOR CLASS ACTION PROMOTERS

A Identifying Class Action Targets

Misleading conduct or non-disclosure may attract the attention of ASIC, leading to inquiries, investigations, and civil, criminal or administrative proceedings. ASIC's policy on confidentiality and public comment on its enforcement activities are based on two principles. First, being a government body, it needs to disclose its enforcement activities so as to be accountable to parliament and the public. Secondly, to perform its regulatory functions, it needs to inform and educate the industry about the standards it expects and to deter similar conduct.¹¹³ ASIC's position is therefore that it will usually neither confirm nor deny the existence of an investigation. However, ASIC will generally issue a media release when criminal charges are laid, when significant civil or administrative actions which involve public hearings commence, and when an outcome is achieved.¹¹⁴ Further, ASIC will not settle a civil proceeding or enter into an enforceable undertaking on terms that the settlement or parties be confidential.¹¹⁵ Enforceable undertakings are made available to the public through ASIC's company database and enforceable undertakings register, but may have a limited range of information removed.¹¹⁶

Nonetheless, ASIC's enforcement steps can act as a class action compass by identifying corporations and officers that may have breached the law.¹¹⁷ This is especially the case when ASIC pursues remedies other than compensation for shareholders, such as pecuniary remedies. Even when ASIC obtains compensation for shareholders, there may still be a class action. For example,

113 Australian Securities and Investments Commission, *Regulatory Guide 47 – Public Comment* (May 2005) [RG47.12]–[RG47.14]; Australian Securities and Investments Commission, *Regulatory Guide 100 – Enforceable Undertakings* (March 2007) [3.4].

114 See Australian Securities and Investments Commission, *Regulatory Guide 47 – Public Comment* (May 2005) [RG47.2]–[RG47.10].

115 Australian Securities and Investments Commission, *Regulatory Guide 47 – Public Comment* (May 2005) [RG47.11]; Australian Securities Investments Commission, *Regulatory Guide 100 – Enforceable Undertakings* (March 2007) [3.6].

116 Australian Securities and Investments Commission, *Regulatory Guide 100 – Enforceable Undertakings* (March 2007) [3.7]–[3.9].

117 See James D Cox and Randall S Thomas, 'SEC Enforcement Heuristics: An Empirical Inquiry' (2003) 53 (3) *Duke Law Journal* 737, which examines the overlap between SEC securities enforcement actions and private securities fraud class actions in the US; and Howell E Jackson and Mark J Roe, 'Public Enforcement of Securities Laws: Preliminary Evidence' (Working Paper, Harvard Law School, 2007) 7 <<http://ssrn.com/abstract=1000086>> at 8 September 2008.

Multiplex entered into an enforceable undertaking in relation to the timing of disclosures about cost overruns and delays in the construction of a new stadium at Wembley in the UK which resulted in a \$32 million compensation fund for investors who acquired their shares between 3 February and 23 February 2005.¹¹⁸ In this instance, compensation for shareholders did not prevent the commencement of class action proceedings relating to a broader period, from 2 August 2004 to 30 May 2005.¹¹⁹

In a similar vein, Royal Commissions and the ASX can point class action promoters towards potential class action targets. In the context of a Royal Commission, both HIH and the Australian Wheat Board were followed by shareholder class actions.¹²⁰ The ASX can issue a query as to compliance with a Listing Rule or a price query when there are unusual trading activity or price movements which, along with any response, can be published to the market.¹²¹

ASIC's enforcement steps assist in the naming and blaming stages of the transformation of a share price decline into litigation. ASIC's involvement may suggest or reinforce views that a company or its officers may have engaged in some form of misconduct. The outcome of ASIC's actions may then confirm or disperse the notion that someone is to blame for share losses. However, ASIC's role in identifying potential class actions should not be overstated. In keeping with the rise of consumerism among shareholders, those shareholders who are themselves disgruntled at a corporation's activities will also seek out class action promoters.

B Access to Potential Respondents' Disclosures and Documents

ASIC has the power to conduct oral examinations, issue notices to produce books and documents, and apply for a search warrant to seize books.¹²² It may release transcripts of oral examinations conducted by it under section 19 and related books to a person's lawyer if the lawyer satisfies ASIC that the person is carrying on, or is contemplating in good faith, a proceeding in respect of a matter to which the examination related.¹²³ ASIC considers that the words 'related books' refer to documents formally identified and incorporated in the record of

118 Australian Securities and Investments Commission, 'ASIC Accepts an Enforceable Undertaking From the Multiplex Group' (Press Release, 20 December 2006) <<http://www.asic.gov.au/asic/asic.nsf/byheadline/06-443+ASIC+accepts+an+enforceable+undertaking+from+the+Multiplex+Group?openDocument>> at 8 September 2008.

119 See *P Dawson Nominees Pty Ltd v Multiplex Limited* (2007) 242 ALR 111 [9].

120 The Hon Justice Owen, *The Failure of HIH Insurance* (2003); *Johnstone v HIH Insurance Limited* [2004] FCA 1414 (Unreported, Tamberlin J, 2 November 2004); The Hon Terence Cole QC, *Report of the Inquiry into certain Australian companies in relation to the UN Oil-for-Food Programme* (2006); *Watson v AWB Ltd* [2007] FCA 1367 (Unreported, Gyles J, 22 August 2007).

121 See ASX Listing Rules 18.7 and 18.7A.

122 *ASIC Act* ss 19, 29, 30, 33 and 35.

123 *ASIC Act* s 25(1). *Boys v Australian Securities Commission* (1998) 80 FCR 403, 420 (Heerey J): 'The whole point of s 25(1) is to enable the fruits of the ASIC's compulsory examination to be made available for use in civil litigation in connection with the subject matter of such examination'.

examination, and also to documents referred to directly or indirectly in the record which would help people to understand the record.¹²⁴ ASIC also has a general power to give any person a transcript of an oral examination and related books, but the power is subject to the confidentiality regime in the *ASIC Act*.¹²⁵ However, for a person contemplating a class action in relation to a matter the subject of an examination, the former power will be relied upon as the confidentiality regime does not apply.¹²⁶ ASIC expects an increase in requests for transcripts and related books as shareholder class actions increase.¹²⁷

ASIC may obtain books under a notice or warrant which ASIC may then use, or permit to be used, for the purposes of a proceeding, including a civil proceeding.¹²⁸ The provision has been relied upon to allow two holders of units in a trust to access documents produced by the trustee of the trust to ASIC for use in a suit on behalf of all the unit holders in the trust against the trustee.¹²⁹ A person also has a right to inspect documents which are in ASIC's possession if the person would otherwise be entitled to inspect the documents and ASIC has a general power to allow any person to inspect documents in its possession.¹³⁰

The *ASIC Act* also abolishes the privilege against self-incrimination and, arguably, legal professional privilege so that information which would not be available to private plaintiffs is disclosed through the section 19 examination transcripts and the production of books and documents to ASIC.¹³¹ As such, plaintiffs are not only able to obtain information without having to wait for discovery, they also obtain information that would not normally be available through discovery. Although the privileged information is made available to plaintiffs, it is not admissible in evidence in a proceeding if the person to whom the privilege belongs objects to its admission.¹³²

124 Australian Securities and Investments Commission, *Regulatory Guide 103 – Confidentiality and Release of Information* (November 1995) [RG103.17].

125 *ASIC Act* ss 25(3), 127; *Johns v Australian Securities Commission* (1993) 178 CLR 408, 425.

126 *Johns v Australian Securities Commission* (1993) 178 CLR 408, 428.

127 Jeremy Cooper, 'Corporate Wrongdoing: ASIC's Enforcement Role' (Speech delivered at the International Class Actions Conference 2005, Melbourne Australia, 2 December 2005) 5 <[www.asic.gov.au/asic/pdf/lib.nsf/LookupByFileName/ICAC2005_speech_021205.pdf](http://www.asic.gov.au/asic/pdf/lib.nsf/LookupByFileName/ICAC2005_speech_021205.pdf/$file/ICAC2005_speech_021205.pdf)> at 8 September 2008.

128 *ASIC Act* s 37(4). 'Proceedings' is defined broadly in *ASIC Act* s 5.

129 *Walsh v Permanent Trustee Australia Ltd (No4)* (1994) 14 ACSR 653, 654.

130 *ASIC Act* ss 37(7)(a) and (b).

131 *ASIC Act* ss 68, 69; *Corporate Affairs Commission of New South Wales v Yuill* (1991) 172 CLR 319; *Australian Securities Commission v Dallegles Pty Ltd* (1992) 6 ACSR 674; *Walsh v Permanent Trustee Australia Ltd (No4)* (1994) 14 ACSR 653. The force of Yuill's case and its progeny has been questioned due to the High Court in *Daniels Corporation International Pty Limited v ACCC* (2002) 213 CLR 543, holding that s 155 of the *Trade Practices Act 1974* (Cth) did not impliedly abrogate legal professional privilege and that Yuill's case may now be decided differently. See *Daniels v ACCC* (2002) 213 CLR 543, 560, 567. The uncertainty is reinforced by the Federal Government determining that it was necessary to pass special legislation to override legal professional privilege in relation to ASIC's investigations into James Hardie and its asbestos liabilities: see *James Hardie (Investigations and Proceedings) Act 2004* (Cth).

132 *ASIC Act* s 76(1)(d).

The section 19 transcripts and books may also be obtained through a subpoena so that the relevant court's rules would govern the process of obtaining the documents.¹³³ Thus, another avenue exists for obtaining access to helpful documentation. In the shareholder class action area, this procedure is illustrated by *King v GIO* where a subpoena was issued for the production of 'records of examination and related books in the investigation of the first respondent', GIO.¹³⁴ Similarly, in the Multiplex class action, leave to issue a subpoena that sought documents provided by the respondents to ASIC in the course of an investigation, section 19 transcripts and signed or sworn statements from witnesses obtained by ASIC, was granted.¹³⁵ However, ASIC is able to resist the production of materials that are subject to public interest immunity.¹³⁶ In the Multiplex class action, the Full Federal Court held that the public interest in encouraging informers to come forward outweighed the applicant's interest in obtaining the materials for its proceedings.¹³⁷ Those materials which directly or circumstantially conveyed the identity of an informer did not have to be disclosed.¹³⁸ As a result, from the thousands of documents produced, 23 transcripts of section 19 examinations and 36 other documents became exempt from production.¹³⁹

In short, those who may commence a class action are able to 'free ride' on ASIC's evidence collection activities.¹⁴⁰ The 'free ride' reduces the costs of pursuing litigation and improves the prospects of success. Costs are reduced as discovery can be reduced and be better targeted. Prospects are improved as the strength of a case can be assessed, even prior to commencing suit.¹⁴¹ Prospects are also improved where class action promoters are given access to transcripts of adversarial examinations where the witness was required to answer questions under oath while subject to a strict liability criminal offence for non-compliance.¹⁴² The combination of a reduction in the costs needed to take legal action and a higher likelihood of success makes claiming more likely.

133 *Maronis Holdings Ltd v Nippon Credit Australia Ltd* (2000) 18 ACLC 609, 615–16 observing that the *ASIC Act* does not qualify, diminish or remove the court's powers to allow and control access and inspection.

134 *King v GIO Australia Holdings Ltd* (2001) 116 FCR 509.

135 *P Dawson Nominees Pty Ltd v Multiplex Limited* (2007) 64 ACSR 53, [10].

136 Public interest immunity is an exemption from the normal obligation of the party to disclose to a court information and documents for the determination of litigation, because some other aspect of the public interest, usually in respect of national security or the workings of both the enforcement and regulatory arms of the executive government, is likely to be adversely affected.

137 *ASIC v P Dawson Nominees Pty Ltd* (2008) 66 ACSR 704, [48]–[61]. See also Michael Legg and Edmond Park, 'Identity of Regulator's Informers Protected From Disclosure to Class Action Promoters - *ASIC v Dawson Nominees*' (2008) 11 (10) *Inhouse Counsel* 118.

138 *Ibid* [39]–[41].

139 *Ibid* [4], [65].

140 See also James McConvill and Darryl Smith, 'Can Minority Shareholders "Free Ride" on ASIC's Civil Penalty Litigation?' (2002) 20 *Company and Securities Law Journal* 302, 302.

141 *P Dawson Nominees Pty Ltd v Multiplex Limited* (2007) 64 ACSR 53, [28]–[30].

142 *ASIC Act* ss 19 and 63.

C Competition Between ASIC and Class Action Promoters

While ASIC's investigative materials may be available to private plaintiffs to launch class actions, ASIC's enforcement activities may also influence the incentives for commencing a class action. It has been suggested that if ASIC follows through on its investigations with legal proceedings, there may be no funds left for private plaintiffs.¹⁴³ This assumes that ASIC seeks pecuniary penalties that are paid to it rather than compensation orders that are paid to the corporation or a person who suffers damage. However, if compensation orders are made then shareholders may recover their losses making further litigation unnecessary.¹⁴⁴ ASIC may also opt for banning orders or jail terms which result in no depletion of potential class action defendants' resources.¹⁴⁵

ASIC has welcomed, albeit cautiously, 'the emergence of the shareholder class action in Australia as a "self-help" mechanism whereby shareholders are able to seek damages for loss incurred at the hands of directors and advisers who negligently or dishonestly cause loss to those shareholders'.¹⁴⁶ However, there are limits to ASIC's welcome as shown by its claim of public interest immunity over documents in the Multiplex class action. ASIC's Chairman commented on the successful claim, stating that '[o]therwise, there is the risk that fewer people would report matters to us'.¹⁴⁷ ASIC still has a statutory mandate to perform. The relationship between public and private enforcement of the securities laws will continue to develop. ASIC and class action promoters may find themselves competing in relation to cases that ASIC regards as strategically important. Nevertheless, limits to regulator resources and the greater incentive for plaintiffs' lawyers and litigation funders who make money from a lawsuit suggest that ASIC is unlikely to cover the field.¹⁴⁸

143 Michelle Welsh, 'ASIC, Civil Penalties and Compensation Orders Under the *Corporations Act 2001*' (2003) 17(4) *Commercial Law Quarterly* 13, 21; Jean J du Plessis, 'Reverberations After the HIH and Other Recent Australian Corporate Collapses: The Role of ASIC' (2003) 15 *Australian Journal of Corporate Law* 1, 17:

To what extent will ASIC's actions tap the funds of the corporate culprits, leaving virtually nothing to make it worth its while for the 'investors' (primarily shareholders and creditors) to institute action, including class actions, against the corporate culprits?

144 See, eg, Janet Austin, 'Does the Westpoint Litigation Signal a Revival of the ASIC s 50 Class Action?' (2008) 22 *Australian Journal of Corporate Law* 8, explaining the use of *ASIC Act* s 50 by ASIC to recover damages for shareholders and investors; and Australian Securities and Investments Commission, above n 118, where a compensation fund for shareholders did not prevent the commencement of class action proceedings which relate to a broader period.

145 For the range of orders that ASIC has sought, see Welsh, above n 143, 28.

146 Cooper, above n 127.

147 Australian Securities and Investments Commission, 'Full Federal Court Decision – P Dawson Nominees Pty Ltd' (Press Release, 4 July 2008) <<http://www.asic.gov.au/asic/asic.nsf/byheadline/08-150+Full+Federal+Court+decision+-+P+Dawson+Nominees+Pty+Ltd?openDocument>> at 8 September 2008.

148 See John C Coffee Jr, 'Reforming the Securities Class Action: An Essay on Deterrence and its Implementation' (2006) 106 *Columbia Law Review* 1534, 1542–4; and Howell Jackson, 'Variation in the Intensity of Financial Regulation: Preliminary Evidence and Potential Implications' (2007) 24 *Yale Journal on Regulation* 253, 281, reporting that in the United States private enforcement of securities laws, mainly through class actions, imposes significant monetary sanctions in addition to public enforcement.

VI AUSTRALIAN CLASS ACTIONS

A Part IVA of the *Federal Court of Australia Act* Regime

The legislation creating group proceedings in Australia at the federal level is Part IVA of the *Federal Court of Australia Act 1976* (Cth), which was enacted in 1992. A class action brought under this legislation usually has three procedural hurdles to overcome: complying with the requirements for commencing the proceedings in section 33C, complying with the additional pleading requirements in section 33H and avoiding being discontinued pursuant to section 33N. These requirements have been discussed at length on a number of occasions.¹⁴⁹

However, certain features need to be highlighted. They are significant in explaining why the creation of a group of litigants is relatively straightforward and complying with the requirements for initiating class action litigation is undemanding, both of which facilitate claiming. This is not to underestimate the time and cost that class action promoters will incur in administering and evaluating group members' claims, but rather to highlight that the formal requirements for commencing class action proceedings are not onerous. Section 33C provides that a proceeding may be commenced where:

- (a) 7 or more persons have claims against the same person; and
- (b) the claims of all those persons are in respect of, or arise out of, the same, similar or related circumstances; and
- (c) the claims of all those persons give rise to a substantial common issue of law or fact.

The commencement of proceedings is straightforward because there is no 'certification' process that necessitates an applicant demonstrating compliance with section 33C. Rather, the onus is on the respondents to challenge the continuation of a class action.¹⁵⁰ The 'same, similar or related circumstances' requirement of section 33C(1)(b) has been interpreted liberally so that some relationship must exist between the claims but they need not be identical.¹⁵¹ Indeed, the legislation was drafted with the aim of accepting differences as shown by the use of the term 'related'.¹⁵² Equally, the 'substantial common issue of law or fact' requirement in section 33C(1)(c) is not an onerous one, as 'substantial' does not indicate a large or significant issue but instead is 'directed to issues which are "real or of substance"'.¹⁵³ The common issue cannot be

149 See generally, S Stuart Clark and Christina Harris, 'Multi-Plaintiff Litigation in Australia: A Comparative Perspective' (2001) 11 *Duke Journal of Comparative and International Law* 289; Rachel Mulheron, *The Class Action in Common Law Systems* (2004); Damian Grave and Ken Adams, *Class Actions in Australia* (2005); Peter Cashman, *Class Action Law and Practice* (2007); and S Stuart Clark and Christina Harris, 'Class Actions in Australia: (Still) a Work in Progress' (2008) 31 *Australian Bar Review* 63.

150 Clark and Harris (2001), above n 149, 296; *P Dawson Nominees Pty Ltd v Multiplex Limited* (2007) 242 ALR 111, [18].

151 *Zhang v Minister for Immigration, Local Government & Ethnic Affairs* (1993) 45 FCR 384, 404.

152 *Guglielmin v Trescowthick (No 2)* (2005) 220 ALR 515, [48].

153 *Wong v Silkfield Pty Ltd* (1999) 199 CLR 255, 267.

trivial or contrived. Consequently, a class action can be a less cohesive group of entities which allows for larger groups.

The applicant's pleadings in a class action must comply with section 33H, which requires the group to be described and the common questions to be specified, in addition to compliance with the usual pleading requirements.¹⁵⁴ Although this is an additional requirement, compliance is usually achieved by defining the group by reference to the time period in which shares were purchased and crafting a common question around whether conduct was misleading and deceptive or in breach of continuous disclosure requirements.¹⁵⁵

Under section 33N, the Court has a discretion upon its own motion or on application by the respondent to order that the proceeding not continue as a representative proceeding where it is in the interests of justice to do so because: (a) costs would be greater if each group member conducted a separate proceeding; (b) all the relief sought can be obtained by other means; (c) the representative proceeding will not provide an efficient and effective means of dealing with the claims of group members; or (d) it is otherwise inappropriate that the claims be pursued by means of a representative proceeding. Despite section 33N being frequently invoked by respondents, the Court will strain to use case management techniques to try and assist the proceeding to continue, at least to the stage of resolution of the substantial common issues.¹⁵⁶

In addition to the above requirements, class actions in the Federal Court are also characterised by the use of an opt-out procedure which means that every entity that falls within the group description is part of the proceedings unless they affirmatively exclude themselves.¹⁵⁷ If a group member falling within the defined class does not opt out then they are bound by the outcome of the proceedings.¹⁵⁸ The right to opt out is given effect by the requirement that group members receive notice of that right and of the commencement of the proceedings.¹⁵⁹ The opt-out approach generally increases the size of class actions by placing the onus

154 See *Petrusevski v Bulldogs Rugby League Ltd* [2003] FCA 61 (Unreported, Sackville J, 14 February 2004) [23], [38].

155 See, eg, *Dorajay Pty Ltd v Aristocrat Leisure Limited* NSD 362 of 2004, Further Amended Application (2 November 2007); and *P Dawson Nominees Pty Ltd v Multiplex Limited & Anor* VID 1380 of 2006, Application (18 December 2006).

156 See *Bright v Femcare Ltd* (2002) 195 ALR 574, [18] (Lindgren J):
ordinarily one would expect that, in an attempt to give effect to the legislative intention, a means will be sought, by case management techniques, to enable a representative proceeding to continue to the stage of resolution of the substantial common issues on the basis that after that stage is completed, an order under s 33N or directions under s 33Q will be made.

See also, *Bright v Femcare Ltd* (2002) 195 ALR 574, [128]; *Peter Hanne & Associates Pty Ltd v Village Life Limited* [2008] FCA 719 (Unreported, Jacobson J, 22 May 2008) [43] (Jacobson J): 'a strike-out motion is a blunt instrument, to be used only in the event that the Court's case management procedures cannot be adapted to enable the matter to go forward'.

157 *Federal Court of Australia Act 1976* (Cth) s 33J provides for a right to opt out.

158 *Federal Court of Australia Act* s 33ZB requires that a judgment given in a representative proceeding identify the group members affected and binds all such members unless they opted out of the proceeding pursuant to s 33J.

159 *Federal Court of Australia Act* s 33X(1)(a) provides for notice of the right to opt out and the giving of a specified date for that right to be exercised by.

of withdrawal on individual group members so that those who are inactive or not aware of the proceedings are included.

However, litigation funders have been seeking an opt-in or limited group class action¹⁶⁰ as the opt-out procedure encourages ‘free-riding’.¹⁶¹ In the *Multiplex* class action, the Full Federal Court held that a limited group class action was permissible based on its construction of the legislation and because the right to opt out was preserved, although there were practical impediments to actually opting out created by the litigation funding agreement under analysis.¹⁶² However, the Full Federal Court also found that it is impermissible to allow group members to opt in to a Part IV class action already on foot.¹⁶³ While limited group class actions are usually smaller than traditional opt-out class actions, as not everyone who would be in the potential group is included, it allows a litigation funder in a shareholder class action to ‘cherry-pick’ the shareholders with large holdings such as institutional investors. This is discussed further in Part VII C of this article. This then maximises the losses in issue, but minimises the administrative costs associated with processing claims and dealing with group members. As the applicant decides how to structure the class action, it is likely they will choose the approach most conducive to their interests.

The legislation also contains requirements for settlement, judgment and notices.¹⁶⁴ An almost identical procedure also exists in Victoria.¹⁶⁵

The above discussion demonstrates that the Australian class action makes the aggregation of numerous securities claims easy to accomplish, even when individual issues such as causation and damages exist. The infancy of shareholder class actions means that there have not yet been any trials to test the efficacy of such loose groupings. The class action can also be structured to accommodate the class action promoter’s business model.

160 An opt-in and limited group class action vary in that the opt-in class action involves notices being sent to the group members asking them if they would like to participate in an existing class action, while a limited or closed group class action has no such notices as the group is formed by the class action promoter and the proceedings commenced on that group’s behalf only.

161 *IMF Australia Ltd, The Shareholder*, August (2006) 1, 3: ‘IMF will be unlikely to offer funding for a class action if shareholders ... are able to “freeload” on the legal work being paid for IMF’; and Rachael Osman-Chin and Marcus Priest, ‘Funding Headache for Class Actions’, *The Australian Financial Review* (Sydney), 29 September 2006, 58. See also, Joshua S Gans, Stephen King, Gregory Mankiw and Robin Stonecash, *Principles of Economics* (3rd ed, 2006) 212: ‘A free rider is a person who receives the benefit of a good but avoids paying for it’. For the funder to receive a percentage of any recovery, it must first have a funding agreement with each group member. Thus, funders fear that group members will refrain from entering into litigation funding agreements to commence the proceedings and instead will wait for a successful outcome before coming forward so they do not have to pay a portion of their recovery to the litigation funder.

162 *Multiplex Funds Management Limited v P Dawson Nominees Pty Ltd* (2007) 164 FCR 275, 284, 299. The group was defined as, inter alia, persons who ‘have, as at the commencement of this proceeding, entered a litigation funding agreement with International Litigation Funding Partners, Inc’: 295 (French, Lindgren, Jacobson JJ).

163 *Ibid* 280, 296.

164 *Federal Court of Australia Act* ss 33V, 33W, 33X.

165 *Supreme Court Act 1986* (Vic) Pt 4A.

B Federal Court Rules Order 6, Rule 13

Prior to the Full Federal Court's decision in the Multiplex class action, representative proceedings or actions based on the former practices of the Court of Chancery were invoked by class action promoters so as to be able to conduct opt-in or limited group class actions that had been prohibited in the Federal and Victorian Courts.¹⁶⁶ In the shareholder class action context, this occurred in the Australian Wheat Board class action.¹⁶⁷ The procedure in New South Wales was also used by unit holders in a property trust.¹⁶⁸ Federal Court Rule Order 6, rule 13 provides:

Where numerous persons have the same interest in any proceeding the proceeding may be commenced, and, unless the Court otherwise orders, continued, by or against any one or more of them as representing all or as representing all except one or more of them.

The rule has been interpreted as being composed of a jurisdictional element, that is, whether there are numerous persons with the same interest in any proceedings so as to allow proceedings to commence; and a discretionary element, that is, whether there are factors which make a representative proceeding undesirable so that a court should otherwise order.¹⁶⁹

Typically a proceeding may be commenced if 'numerous persons have the same interest',¹⁷⁰ but the factors against a representative proceeding must be aired through requesting the court to use its discretion to prevent the plaintiff from continuing to prosecute the proceedings in a representative capacity. The rules do not address whether or not consent is required from group members; the right of such members to opt out of or opt into the proceedings; the position of persons under a disability; alterations to the description of the group; settlement and discontinuance of the proceedings; and the giving of various notices to group members.¹⁷¹

If the Part IV class action regime continues to be interpreted so as to allow limited group class actions, then the greater certainty created by the more detailed Part IV regime is likely to see representative proceedings return to obscurity. Further, the Supreme Court of New South Wales in a ruling on its

166 See Bernard Murphy and Camille Cameron, 'Access to Justice and the Evolution of Class Action Litigation in Australia' (2006) 30 *Melbourne University Law Review* 399, 419–20.

167 See *John Watson and Kaye Watson v AWB Limited*, Federal Court of Australia NSD 659 of 2007, Application (17 April 2007). However, in *Watson v AWB Limited* [2007] FCA 1367 (Unreported, Gyles J, 22 August 2007), the applicant was granted leave to amend the pleadings so as to commence proceedings under Pt IVA of the *Federal Court of Australia Act 1976* (Cth).

168 *O'Sullivan v Challenger Managed Investments Limited* (2007) 214 FLR 1.

169 *Carnie v Esanda Finance Corporation Ltd* (1995) 182 CLR 398, 405, 415, 427, dealing with the equivalent rule in the Supreme Court of New South Wales' former court rules. The historical development of the representative action is set out in John Sorabji, 'Class Actions: Reinventing the Wheel' (Paper Presented at the Civil Justice Council Collective Address Event, Theobald's Park, 26–27 March 2008) <<http://www.civiljusticecouncil.gov.uk/files/beaumont-house-minutetwo.doc>> at 18 September 2008.

170 *Carnie v Esanda Finance Corporation Ltd* (1995) 182 CLR 398, 404–5.

171 *Esanda Finance Corporation Ltd v Carnie* (1992) 29 NSWLR 382, 388, 390; *Fostif Pty Ltd v Campbells Cash & Carry Pty Ltd* (2005) 63 NSWLR 203, 258.

equivalent provision held that, *inter alia*, the relief claimed in a representative proceeding must be ‘beneficial to all’ and representative proceedings will not be appropriate for damages claims where loss must be demonstrated by each individual.¹⁷² The decision had the potential to significantly restrict the scope of representative proceedings as it would have prevented representative proceedings being brought in New South Wales for damages claims where quantum, reliance and/or causation had to be individually proved. New South Wales subsequently amended its court rules but Order 6, rule 13 remains in the same form so that the decision remains persuasive in the Federal Court.¹⁷³

However, if the Part IV class action was only allowed to be structured so as to apply to the entire group as a result of a further appeal or legislative amendment, or class action promoters’ desire to use an opt-in class action, then Order 6, rule 13 may be used as a fall-back position. Additionally, where other Part IV class action requirements are a hindrance to commencing suit, then Order 6, rule 13 may be called upon.

C Liability for Adverse Costs Orders

The usual costs rule in Australian litigation is that a losing party is liable for the other side’s costs, albeit only a portion of the costs actually incurred.¹⁷⁴ This approach to costs has frequently been cited as discouraging class action litigation.¹⁷⁵ However, in the federal class action context, the costs rule is limited to the representative party only and does not apply to other group members.¹⁷⁶ Similarly in a representative proceeding, such as pursuant to Order 6, rule 13 of the Federal Court Rules, it is unusual for group members to be liable for costs,

172 *O’Sullivan v Challenger Managed Investments Limited* (2007) 214 FLR 1, 12, 16, 18, interpreting rule 7.4 of the *Uniform Civil Procedure Rules* as it was drafted from 15 August 2005 until amended on 9 November 2007. See *Uniform Civil Procedure Rules (Amendment No 19) 2007*, NSW Government Gazette No 167, 9 November 2007. The decision and its potential ramifications are discussed in more detail in Michael Legg, Vanessa McBride and S Stuart Clark, ‘The Challenge of Class Actions in the Supreme Court of NSW’ (2007) 45(8) *Law Society Journal* 56.

173 See the comments of Jacobson J in *Multiplex Funds Management Limited v P Dawson Nominees Pty Limited* (2007) 164 FCR 275, 298. An appeal was lodged against Justice White’s decision in *O’Sullivan v Challenger Managed Investments Ltd* (2007) 214 FLR 1, but was later withdrawn.

174 *Ruddock v Vadarlis* (2001) 115 FCR 229, [11]; *Hughes v Western Australia Cricket Association (Inc)* (1986) ATPR 40, 48, 136; Victorian Law Reform Commission, *Civil Justice Review*, Report No 14 (2008) 648, estimating that only 60 to 70 per cent of costs are recovered.

175 Dewees, Prichard and Trebilcock, above n 8, 160–1; Peta Spender, ‘Securities Class Actions: A View from The Land of the Great White Shareholder’ (2002) 31 *Common Law World Review* 123, 143, 160; Vince Morabito, ‘Contingency Fee Agreements with Represented Persons in Class Actions – An Undesirable Australian Phenomenon’ (2005) 31 *Common Law World Review* 201, 206.

176 *Federal Court of Australia Act 1976* (Cth) s 43(1A). See also, *Supreme Court Act 1986* (Vic) s 33ZD.

although the power to award costs against them has been argued to exist.¹⁷⁷ As a consequence, group members can avoid the risk of being liable for costs if the case is unsuccessful. The costs rule can also be circumvented by selecting an impecunious representative party.¹⁷⁸ One tactic is to structure the group so that its representative is a person who has no capacity to pay costs, thereby removing the deterrence to commencing class actions.

The availability of litigation funding also impacts on the costs equation as applicants will usually obtain an indemnity for any adverse costs order from the litigation funder (see Part VII A of this article). If the litigation funder is an entity of financial substance and is unable to terminate the indemnity obligation under the funding agreement, then shareholders will not be deterred by the costs rule. Equally, respondents will gain some comfort from knowing that the applicant will be able to pay an adverse costs order. However, if the above two assumptions do not hold then the indemnity may be worthless, exposing the applicant to a costs liability. Where the assumptions hold, then the costs rule becomes a factor in whether litigation funding will be provided as the funder will have the potential liability. The impact of the costs rule on a litigation funder is less than on the average litigant as the funder is better able to spread the risk of an adverse costs order because the risk can be spread across its inventory of cases and is borne by its own shareholders.

Respondents have countered the tactic of an impecunious applicant or use of litigation funding by seeking an order for security for costs from the applicant or funder.¹⁷⁹ This is an order that can be made by the court requiring an applicant or funder to pay into court, provide a bank guarantee, or otherwise give security for, an amount equal to the estimated recoverable costs of the proceedings. Whilst security for costs is available in class actions, the courts have been reluctant to make such orders.¹⁸⁰ However, an order for security for costs will be made in appropriate circumstances, such as against an incorporated organisation.¹⁸¹

177 In a representative proceeding it has frequently been stated that the represented parties (group members) are not liable in costs: *Carnie v Esanda Finance Corp Ltd* (1995) 182 CLR 398, 420; *O'Sullivan v Challenger Managed Investments Ltd* (2007) 214 FLR 1, [68]. However, in *Burns Philp & Co Ltd v Bhagat* [1993] 1 VR 203, 223, it was held that represented parties are potentially liable for costs. Peter Taylor (ed), *Richie's Uniform Civil Procedure NSW* (2008) [7.4.35] opines that the true position is that, while there is power to award costs against the represented persons, it will not often be appropriate to order costs against an inactive individual person who is within the class of those represented in the proceedings.

178 *Cook v Pasmenco Ltd (No. 2)* (2000) 107 FCR 44, 50.

179 Cashman, above n 149, 434–42. See also *P Dawson Nominees Pty Ltd v Multiplex Limited* (2007) 242 ALR 111 [28], referring to an extant motion for security for costs.

180 See *Bray v F Hoffman-La Roche Ltd & Others* (2003) 130 FCR 317, 346–9 (Carr J), 374 (Finkelstein J); *Woodhouse v McPhee* (1997) 80 FCR 529; *Ryan v Great Lakes Council* (1998) 154 ALR 584; *Ryan v Great Lakes Council* (1998) 155 ALR 447; *Nendy Enterprises Pty Ltd v New Holland Australia Pty Ltd* [2001] FCA 582 (Unreported, Whitlam J, 9 November 2001); and *Nendy Enterprises Pty Ltd v New Holland Pty Ltd* [2002] FCA 550 (Unreported, Tamberlin J, 10 May 2002).

181 See *Tobacco Control Coalition Inc v Philip Morris (Australia) Ltd* [2000] FCA 1404 (Unreported, Wilcox J, 14 September 2000), where a security for costs order was made against an incorporated organisation that was specifically established to commence a class action against the tobacco industry.

The usual costs rule which would dissuade small shareholders, and even many institutional shareholders, when the potential recovery is compared to the costs of litigation, is ameliorated by the class action approach to costs and the rise of litigation funding. The costs obstacle to claiming is therefore reduced or removed. The costs disincentive could be further reduced if the ‘loser pays’ principle was abandoned altogether or through the introduction of an exception to the general rule based upon the public interest nature of class action litigation.¹⁸² To date, such a development has met with little success.¹⁸³

D Class Action Economics – Facilitating Litigation

The class action is designed to facilitate access to justice and, accordingly, results in litigation where previously there may have been none. However, it is also meant to make that litigation more efficient in terms of party and judicial resources that need to be expended to resolve the grouped claims.¹⁸⁴

The pooling of claims means that a claim that may be uneconomic to pursue alone can, when combined with other claims, become worthwhile pursuing.¹⁸⁵ The class action also allows for the cost of bringing the action to be spread across many claimants giving rise to economies of scale.¹⁸⁶ For example, the cost of investigating the merits of a claim is about the same whether there is one claimant or many. However, when the stakes are increased the case is likely to be harder fought which may create additional costs.¹⁸⁷

In the area of shareholder claims, the class action is an attractive procedural vehicle – many of the claims are small and the class action allows for them to be

182 Donnan, above n 11, 94; Spender, above n 175, 144, 160.

183 See *Qantas Airways Ltd v Cameron (No 3)* (1996) 68 FCR 367. See generally *Save the Ridge Inc v Commonwealth* (2006) 230 ALR 411, 413 (Black CJ, Moore and Emmett JJ): ‘the courts have held that there is no special costs regime applicable to “public interest” litigation’.

184 *Wong v Silkfield* (1999) 199 CLR 255, 264; Australian Law Reform Commission, *Grouped Proceedings in the Federal Court*, Report No 46 (1989) [330], [336].

185 See Second Reading Speech, Federal Court of Australia Amendment Bill 1991 (Cth), House of Representatives, 14 November 1991 (Michael Duffy, Attorney-General of Australia) 3177; *Phillips Petroleum Co v Shutts* 472 US 797, 809 (1985): ‘Class actions ... may permit the plaintiffs to pool claims which would be uneconomical to litigate individually. For example, this lawsuit involves claims averaging about \$100 per plaintiff; most of the plaintiffs would have no realistic day in court if a class action were not available’; and *P Dawson Nominees Pty Ltd v Multiplex Limited* (2007) 242 ALR 111 [24].

186 See Second Reading Speech, Federal Court of Australia Amendment Bill 1991 (Cth), House of Representatives, 14 November 1991 (Michael Duffy, Attorney-General of Australia) 3177; *Deposit Guaranty National Bank v Roper* 445 US 326, 338 (1980); and *P Dawson Nominees Pty Ltd v Multiplex Limited* (2007) 242 ALR 111, [25].

187 *Bright v Femcare Ltd* (2002) 195 ALR 574, 607–8, referring to interlocutory applications by respondents in class actions increasing costs. See also Justice Kevin Lindgren, ‘Keynote Address – Class Actions and Access to Justice’ (Keynote address at the *International Class Actions Conference 2007*, 25 October 2007, Melbourne Australia) 2–3, referring to applicants ensuring compliance with *Federal Court of Australia Act 1976* (Cth) ss 33C, 33H and 33N as a way to avoid interlocutory applications.

aggregated, creating a single substantial claim.¹⁸⁸ The group also tends to be large, dispersed and disorganised, and therefore suffers from a collective action dilemma.¹⁸⁹ The benefits to the group, namely recovery of damages, exceed the aggregate costs to the individual members of the group, making action desirable. However, because benefits are dispersed among the group, an individual may be unwilling to incur the cost of action alone, as individual costs would exceed their individual benefits. The class action allows the benefit to be pursued by sharing the costs.¹⁹⁰

There is also an ability to include large shareholders, such as institutional investors, in class actions. Large shareholders can also benefit from the cost savings. They will weigh the potential recovery with the costs involved, which may include greater opportunity costs than for small shareholders. For example, if they commence litigation they will have the cost of lost management time from instructing lawyers, the costs of complying with discovery and the impact on business relationships.¹⁹¹ As a group member in a class action, those costs are reduced as they have an almost anonymous role, albeit with little control over the litigation. The aggregation and economies of scale advantages that flow from class actions have led to suggestions of a ‘small claimant’ and ‘large claimant’ dichotomy in describing class actions.¹⁹² Both small and large claimants may be present in any shareholder class action, and are able to benefit from the class action mechanism.

The ability to aggregate claims and obtain economies of scale is also important because it attracts class action promoters who see the ability to make profitable returns from investing in the litigation. Indeed, the ability to profit provides the incentive for a class action promoter to investigate if a cause of action exists, to consider prospects of success and to organise the group.¹⁹³ The economics of the class action are such that they transform non-viable claims, either because of the small loss involved or the opportunity costs associated with litigation, into high stakes litigation. As such, claims that otherwise would not take place are now able to be pursued.

E Settlement Incentives

The ability to easily initiate the class action procedure, class action economics and costs rules create the conditions that provide a strong incentive for

188 Spender, above n 175, 124; *In re Dennis Greenman Securities Litigation* 829 F2d 1539 (11th Cir 1987) at 1545: ‘a purpose of class actions is to enable parties, who have insufficient means to pursue their individual claims, to pool their resources and pursue their common complaints’.

189 See *In re Auction Houses Antitrust Litigation* 197 FRD 71 (S.D.N.Y 2000) 78.

190 Ibid 72: ‘Class action lawsuits protect plaintiffs’ rights and promote accountability by permitting dispersed, disorganized plaintiffs who may have suffered only small injuries to find redress by acting as a group where they would lack sufficient incentive to do so individually.’

191 Legg, above n 33.

192 *P Dawson Nominees Pty Ltd v Multiplex Limited* (2007) 242 ALR 111, [24].

193 See *Mobil Oil Australia Pty Ltd v State of Victoria* (2002) 211 CLR 1, 77; and John C Coffee, ‘Understanding the Plaintiff’s Attorney: The Implications of Economic Theory for Private Enforcement of Law Through Class and Derivative Actions’ (1986) 86 *Columbia Law Review* 669.

respondents to settle. The incentive to settle has the effect of encouraging claims because a payment is likely.

The commencement of a class action creates a number of direct and indirect costs for a corporation. The ability to aggregate claims through the class action means that the corporation faces a potentially large but uncertain financial liability.¹⁹⁴ The uncertainty flows from the corporation not knowing the size of the group, who is in the group or the strength of each group member's claim.¹⁹⁵ The limited group class action theoretically makes it possible to ascertain the size of the group and identity of group members, but the applicant will rarely have an incentive to disclose this information prior to advanced settlement discussions. The only claim that can be evaluated is the one belonging to the representative party. Due to the group being composed of claims based on the 'same, similar or related circumstances', there may be differences in the facts and strength of each claim. Uncertainty gives rise to a large variance in the expected outcome of the proceedings, which can increase risk aversion and magnify the need for a sum certain settlement.¹⁹⁶ Corporations can ameliorate the above uncertainty to a degree if they expend resources examining the volume of shares traded and share price movements, but this will only yield general rather than specific information about quantum.

The size and complexity of class actions means they can be unwieldy and lengthy, giving rise to substantial costs.¹⁹⁷ Management's time is diverted from the business to defending the litigation, including instructing lawyers, providing witness statements and attending to discovery.¹⁹⁸ The cost of lawyers and expert witnesses is incurred. The commencement of proceedings, associated press releases by class action promoters and the existence of a contingent liability may dampen corporate performance, including decreasing the share price and

194 Henry Friendly, *Federal Jurisdiction: A General View* (1973) 120.

195 *Dorajay Pty Ltd v Aristocrat Leisure Limited* [2008] FCA 1311 (Unreported, Stone J, 26 August 2008) [13]: 'Until the class of participating group members is closed and the members of the closed class identified there can be no final settlement and no distribution of settlement monies to members of the class'.

196 Charles Silver, "'We're Scared to Death": Class Certification and Blackmail' (2003) 78 *New York University Law Review* 1357, 1373–5.

197 Milton Handler, 'The Shift from Substantive to Procedural Innovations in Antitrust Suits – The Twenty-Third Annual Antitrust Review' (1971) 71 *Columbia Law Review* 1, 7–10; Stephanie Planchich, Svetlana Starykh and Brian Saxton, *2008 Trends: Subprime and Auction-Rate Cases Continue to Drive Filings, and Large Settlements Keep Averages High* (2008) NERA Economic Consulting 14 <http://www.nera.com/Publication.asp?p_ID=3544> at 8 September 2008. For example, the Aristocrat class action was commenced in 2003 and the hearing of stage 1 (liability and the damages claim of the representative party) concluded on 30 October 2007. If the matter had not settled then the proceedings would still have needed to resolve the individual claims of each group member.

198 See, eg, Australian Broadcasting Corporation, 'Aristocrat Agrees on \$145m Settlement', *Lateline Business*, 28 August 2008 <<http://www.abc.net.au/lateline/business/items/200808/s2349645.htm>> at 8 September 2008, where the CEO of Aristocrat Leisure was interviewed about the settlement of a class action and stated: 'Obviously it will be a great weight off the company, its been a distraction for several years – for the best part of five years – and I think now it will enable management of the company to get on with its real business'.

attracting media scrutiny with associated effects on reputation.¹⁹⁹ Even if a successful defence is achieved, the corporation does not recover all of its direct, let alone indirect costs, as the costs rules do not provide for complete recovery. Further, the usual means of managing a costs exposure such as Calderbank letters or offers of compromise that put an opponent at risk of indemnity costs should they not recover damages greater than the settlement offer are frequently unhelpful in the class action context.²⁰⁰ The corporation does not know what the claim is worth, making a genuine compromise difficult. The applicant may also rely on it having inadequate information to be able to assess the offer.²⁰¹

The evaluation of settlement involves comparing the amount of a potential judgment, discounted by the probability that it will not be successful, plus the transaction costs of further litigation, with the cost of the settlement package.²⁰² Consequently, even if a corporation believes its prospects of success are high, say 80 per cent, and the claim is \$100 million, then settling for \$20 million to remove the risk of liability and avoid further costs is economically rational.²⁰³

The above reasoning is supported by experience. In *King v GIO*, a final group of 23 099 claimants received about \$2.10 per share, the plaintiffs' lawyers received fees of about \$17 million (including a 25 per cent uplift of their hourly fee and disbursements) and the company converted a potential liability of \$151 million to a settlement of \$97 million.²⁰⁴ *King v GIO* demonstrates that settlements are an attractive option because multiple claims are removed from the judicial system, and corporations can achieve certainty and buy peace.²⁰⁵

After five years of litigation, the Aristocrat class action has recently settled for \$145 million. This was comprised of a fund of \$109 million for group members who had entered into a litigation funding agreement (about 556 shareholders), \$27 million for unfunded group members (about 2300 shareholders) and \$8.5 million for legal fees.²⁰⁶ The uncertainty over the quantum of the claim is illustrated by the solicitors for the representative party earlier estimating a total damages bill of up to \$396 million, the litigation funder estimating \$240 million

199 Silver, above n 196, 1406.

200 See Federal Court Rules, Order 23, where there is a presumptive entitlement to indemnity costs if the damages recovered is less than the settlement offer; and *Port Kembla Coal Terminal Ltd v Braverus Maritime Inc (No 2)* (2004) 212 ALR 281, 287–90: a Calderbank offer will result in indemnity costs if in all the circumstances the failure to accept the settlement offer was unreasonable.

201 Grave and Adams, above n 149, 438; Cashman, above n 149, 442–8.

202 See, eg, *Williams v FAI Home Security Pty Ltd (No. 4)* (2001) 180 ALR 459, [19]; *Evans v Jeff D* 475 US 717 (1986) 734; and Stephen Colbran et al, *Civil Procedure – Commentary and Materials* (3rd ed, 2005) 777–81.

203 This example is taken from Gary Sasso, 'Class Actions: De Minimis Curat Lex?' (2005) 31 (4) *Litigation* 16, 18.

204 *King v AG Australia Holdings Pty Ltd* [2003] FCA 980 (Unreported, Moore J, 17 September 2003) [4]–[15].

205 Clark and Harris (2008), above n 149, 85.

206 *Dorajay Pty Ltd v Aristocrat Leisure Limited* [2008] FCA 1311 (Unreported, Stone J, 26 August 2008) [7]–[8]; Alex Boxsell, 'Deal to Spur Class Actions', *The Australian Financial Review* (Sydney), 29 August 2008, 3.

and Aristocrat estimating damages between \$10 million and \$20 million.²⁰⁷ Even if one assumes that the figures included some element of gamesmanship, there is still a wide variation in the estimates as to the value of the class action.

Not all cases result in such large settlements, but they nonetheless settle. The Harris Scarfe class action was originally a claim for \$20 million but settled for \$3 million, with \$1.55 million going to the plaintiffs' lawyers and the rest being shared by a class of 3832 investors.²⁰⁸ Shareholders received around 5 cents for shares which had been worth as much as \$3.35.²⁰⁹ The Telstra class action settled on 13 December 2007 resulting in a \$300 million claim being settled for \$5 million. The settlement resulted in \$1.25 million being paid to the applicants' lawyers and about \$3.75 million being shared by up to 29 000 investors.²¹⁰

VII LITIGATION FUNDING

A Background

Historically, improperly encouraging litigation (maintenance) and funding another person's litigation for profit (champerty) were torts and/or crimes in all Australian jurisdictions. The common law prohibition of litigation funding was justified in part by a doctrinal concern, namely that the judicial system should not be the site of speculative business ventures. However, the primary aim was to prevent abuses of court process (for example, vexatious or oppressive litigation, elevated damages, suppressed evidence, suborned witnesses) for personal gain.²¹¹ Legislation in the Australian Capital Territory, New South Wales, South Australia and Victoria has expressly abolished maintenance and champerty as a crime and as a tort.²¹² It seems likely that maintenance and champerty are obsolete as crimes at common law.²¹³ However, in these jurisdictions, while there is no criminal or civil liability for maintenance and/or champerty, the abolishing legislation does 'not affect any rule of law as to the cases in which a contract is to be treated as contrary to public policy or as otherwise illegal'.²¹⁴

207 Vanda Carson, 'Huge Settlement a Poker in the Eye for Aristocrat', *The Age* (Melbourne), 20 May 2008, B3; Katherine Jimenez, 'Aristocrat Antagonists Slug it out in Court', *The Australian* (Sydney), 6 October 2007; IMF Australia, 'Aristocrat Leisure Ltd MPA by the Shareholders' (2008) IMF Australia <<http://www.imf.com.au/cases.asp?ID=27&showlist=1>> at 8 September 2008.

208 *Guglielmin v Trescowthick (No. 5)* (2006) FCA 1385, [13]–[18], [31]; Matthew Drummond, 'Scarfe Action Settled', *The Australian Financial Review* (Sydney), 13 October 2006, 16.

209 Colin James, 'Shares Fall From 3.35 to Just 5c', *The Advertiser* (Adelaide), 3 October 2006 <<http://www.news.com.au/adelaidenow/story/0,22606,20514641-5006301,00.html>> at 8 September 2008.

210 *Taylor v Telstra Corporation Ltd* [2007] FCA 2008; [34]–[37]; Susannah Moran, 'Blackburn Slams Slaters Over Telstra', *The Australian* (Sydney), 16 November 2007, 37.

211 Michael Legg and Greg Williams, 'The High Court Gives Litigation Funding Legitimacy, Yet Questions Remain' (2006) 44 *Law Society Journal* 53, 54.

212 *Civil Law (Wrongs) Act 2002* (ACT) s 221; *Maintenance, Champerty and Barratry Abolition Act 1993* (NSW) ss 3, 4, 6; *Criminal Law Consolidation Act 1935* (SA) sch 11 ss 1(3), 3; *Wrongs Act 1958* (Vic) s 32 and *Crimes Act 1958* (Vic) s 322A.

213 See *Clyne v NSW Bar Association* (1960) 104 CLR 186, 203; and *Brew v Whitlock* [1967] VR 449, 450.

214 See, eg, *Maintenance, Champerty and Barratry Abolition Act 1993* (NSW) s 6; *Wrongs Act 1958* (Vic) s 32 (2).

A litigation funder is a commercial entity that contracts with one or more potential litigants. The funder pays the cost of the litigation, including its own investigation and analysis costs, legal fees and disbursements such as filing fees and expert's costs, and indemnifies the litigant against the risk of paying the other party's costs if the case fails.²¹⁵ In return, if the case succeeds, the funder is paid a percentage or share of the proceeds (usually after reimbursement of costs). The percentage of the proceeds is as agreed with the client, and is typically between one-third and two-thirds of the proceeds.²¹⁶ The percentage may vary from litigant to litigant, with institutional investors who have large shareholdings being able to negotiate a lower percentage. The funding agreement, including the indemnity, is usually capable of termination by the funder at its sole discretion upon giving a specified number of days notice.²¹⁷

B The High Court Legitimises Litigation Funding

In *Campbells Cash and Carry Pty Limited v Fostif Pty Ltd*, the High Court considered the legality of litigation funding for the first time.²¹⁸ The High Court held five to two that litigation funding was not an abuse of process or contrary to public policy. The joint judgment of Gummow, Hayne and Crennan JJ explained that in jurisdictions which had abolished maintenance and champerty as crimes and torts – New South Wales, Victoria, South Australia and the Australian Capital Territory – there were no public policy questions beyond those that would be relevant when considering the enforceability of the agreement for maintenance of the proceedings as between the parties to the agreement.²¹⁹ In other words, once the legislature abolished the crimes and the torts of maintenance, these concepts cannot be used to found a challenge to proceedings which are being maintained. Their only relevance is in a dispute between plaintiff and funder about the enforceability of the agreement. The Court did not decide the position for those states where legislation had not abolished maintenance and champerty as crimes and torts – that is, Western Australia, Queensland, Tasmania and the Northern Territory.

The joint judgment opined that fears about a funder conducting themselves in a manner inimical to the due administration of justice could be addressed by existing doctrines of abuse of process and the courts' ability to protect their processes.²²⁰ Chief Justice Gleeson and Kirby J agreed with the reasoning of the joint judgment.²²¹ Justices Callinan and Heydon dissented on this issue.²²² The

215 Carman Yung, 'Litigation Funding: Officious Intermeddling or Access to Justice?' (2005) 15 *Journal of Judicial Administration* 61, 62; Vicki Waye, 'Conflicts of Interests Between Claimholders, Lawyers and Litigation Entrepreneurs' (2007) 19(1) *Bond Law Review* 225, 297.

216 Standing Committee of Attorneys-General, *Litigation Funding in Australia* (2006) 4; Waye, above n 215, 252, 283.

217 Waye, above n 215, 251, 297.

218 (2006) 229 CLR 386.

219 *Campbells Cash and Carry Pty Limited v Fostif Pty Ltd* (2006) 229 CLR 386, 432–3.

220 *Ibid* 435.

221 *Ibid* 407, 451.

222 *Ibid* 496.

Full Federal Court subsequently applied *Fostif* and interpreted the majority as requiring a respondent to 'identify what exactly is feared; in particular, what exactly is the corruption of the Court processes that is feared' on the particular facts before the Court for an abuse of process to be said to exist.²²³

C Litigation Funding Promotes Shareholder Class Actions

Litigation funding is advocated on the basis of providing access to justice, spreading the risk of complex litigation, and improving the efficiency of litigation through introducing commercial considerations that will aim to reduce costs, but is also a business aimed at maximising profits.²²⁴ Litigation funding is likely to increase the amount of shareholder class action activity by making available the financing needed for identifying and prosecuting potential law suits. The amount of funding available has been increasing with overseas hedge funds and litigation funders moving into the Australian market.²²⁵ Further, the litigation funder is able to harness the above factors, such as investor discontent, new causes of action and the class action procedure to direct them towards the construction of a viable lawsuit.

Litigation funders are concerned with their return on investments, especially if they are listed corporations or trying to attract investors. Consequently, the funder has an incentive to monitor corporate disclosures, share price movements and regulator inquiries so as to be able to identify litigation that has the best prospects of success so as to achieve a profitable investment of their resources. The above discussion demonstrates that the prospects of a shareholder class action succeeding are much improved because of the statutory causes of action, mandatory continuous disclosure and access to ASIC's documents. The class action is economically attractive for funders because the aggregation of many small claims can multiply the potential return. Further, the economics of class actions also apply to the litigation funder's advantage. Because of economies of scale the cost of bringing the action only increases marginally when plaintiffs are added, but the potential return increases by a much larger amount.²²⁶ Shareholder

223 *Deloitte Touche Tohmatsu v JP Morgan Portfolio Services Ltd* (2007) 158 FCR 417, 424 (Tamberlin and Jacobson JJ) and 431–2 (Rares J dissenting but on another issue).

224 *Fostif Pty Ltd v Campbells Cash & Carry Pty Ltd* (2005) 63 NSWLR 203, 226; *QPSX Ltd v Ericsson Australia Pty Ltd (No 3)* (2005) 219 ALR 1, 13–14; Yung, above n 215, 80: 'professional litigation funding is not intended to be altruistic. The overriding objective of the industry is the maximisation of profits'.

225 The largest funder in Australia, IMF (Australia) Limited, has received expressions of interest from US hedge funds. See Joshua Lipton, 'Funding - Contingency Plans', *Litigation 2006 - Supplement to The American Lawyer and Corporate Counsel* (2006) 18. The Multiplex class action is funded by International Litigation Funding Partners, Inc and one of the Centro class actions is funded by Commonwealth Legal Funding LLC. See *Multiplex Funds Management Limited v P Dawson Nominees Pty Ltd* (2007) 164 FCR 275, 284; and Slater and Gordon Lawyers, 'Centro Shareholder Actions' (2008) <<http://www.slatergordon.com.au/pages/centro.aspx>> at 8 September 2008.

226 See Assaf Hamdani and Alon Klement, 'The Class Defense' (2005) 93 *California Law Review* 685, 695:

class actions are also attractive because it is easier, though not easy, to estimate the compensation that may be recovered as it turns largely on share price movements, which can be more readily quantified than compensation for personal injury.²²⁷ Further, the evidence will be largely documentary, which can be objectively assessed, as compared to a cause of action hinging on oral evidence or recollection that is more easily open to be discredited and therefore provides less certainty in relation to prospects of success.²²⁸

Litigation funders are also likely to increase the number and size of shareholder class actions through recruiting institutional shareholders. Institutional investors are attractive clients for litigation funders because one funding agreement captures a large number of shares and their associated potential recovery. A litigation funder must expend much more effort to obtain funding agreements covering a sufficient number of shares when they are held by individual investors.²²⁹ Litigation funders have an incentive to cultivate relations with institutional investors so that the funder can facilitate the commencement of a class action whenever a sufficient number of institutions have suffered losses, because the funder can take a fee from any successful recovery. As such, litigation funders can be expected to bring class actions to an institution's notice and make as cogent an argument for participating as possible.

VIII CONCLUSION

A The Perfect Storm

The confluence of the above events has led to the rise of the shareholder class action in Australia and, it is submitted, the aptness of the perfect storm analogy used in this article. The creation of the perfect storm has been explained through the use of the transformation theory. The rise of the shareholder class action presents a study in how an experience such as a share price decline or corporate collapse is transformed into a grievance for which a legal remedy is sought. The above analysis also adds to the transformation theory by providing a tangible example of the factors which promote naming, blaming and claiming, and by illustrating how one factor may reinforce or strengthen another. The factors that have created the transformation may be summarised as follows:

By allowing plaintiffs to aggregate their common claims against the wrongdoer, the class action allows the plaintiff group to exploit economies of scale. Furthermore, increasing the amount at stake renders class representation financially appealing for lawyers. This means that the plaintiff class will file and litigate a suit even when each plaintiff, acting individually, would find litigation economically infeasible.

227 See David Tabak and Frederick Dunbar, 'Materiality and Magnitude: Event Studies in the Courtroom' in Roman Weil, Michael Wagner and Peter Frank (eds), *Litigation Services Handbook – The Role of the Financial Expert* (3rd ed, 2001); and Dunbar and Sen, above n 80.

228 Christopher Webb, 'A Man Named Sue', *The Sunday Age* (Melbourne), 17 September 2006, 17; Waye, above n 215, 251, 280–2.

229 Legg, above n 33, 485.

1 *Willingness to Blame*

There has been a change in the mindset of shareholders as to how a share price decline is perceived through share trading becoming a 'consumer' activity so that compensation is expected if a share does not perform as expected. The creation of new causes of action in the *Corporations Act* and *ASIC Act* based on misleading and deceptive conduct and continuous disclosure have transformed shareholders' views as to who is at fault for a share price decline. An important step in the process of moving from misfortune to injustice is the perception that some human or corporate agent has caused the injury, and not some external force of nature.²³⁰ The *Corporations Act* and *ASIC Act* perform that role by assigning responsibility and creating a new morality.²³¹ Further, there is growing participation of institutional investors in shareholder class actions due to the increasing acceptance that litigating to recover losses is a legitimate and cost-effective business decision.

2 *Improved Prospects of Success*

A shareholder, individual or institution, now has better prospects of success in litigation due to the broad statutory causes of action based upon misleading or deceptive conduct and contravention of continuous disclosure requirements. The statutory provisions focus on consequences so that there is no need to prove a particular state of mind as in fraud or establish a specified degree of fault as in negligence. Prospects are also improved by being able to get a preview of the evidence through access to a potential respondent's documents and adversarial examinations that ASIC has obtained. The class action procedure is easy to initiate and difficult to successfully challenge so that a number of alleged losses can be accumulated and brought to bear in the form of pressure to settle or a high stakes trial.

3 *Reduced Costs*

The cost of litigating has been reduced. The class action provides a mechanism for converting claims that are individually uneconomic to pursue into a viable class action lawsuit and reduces costs through economies of scale. Costs may also be reduced as a consequence of the causes of action being easier to prove and the availability of access to potential evidence gathered by ASIC so that the resources needed to gather evidence are reduced. Costs still exist because the allowance of less cohesive groupings in shareholder class actions means there are a number of individual issues that cannot be resolved simultaneously such as complex questions of causation and damages, although class action promoters are

230 Sarat, above n 5, 434, 436.

231 See Felstiner, Abel and Sarat, above n 5, 643.

taking steps to streamline this aspect of the litigation. Costs are also proving to be considerably lower than class action promoters' recoveries.²³²

4 *Class Action Promoters*

Central to class action litigation is the entrepreneur who can identify the potential law suit, organise a representative party and group members, provide financing to fund the costs that are incurred and co-ordinate the resources needed to achieve a favourable settlement or judgment. Plaintiffs' lawyers and/or litigation funders, referred to in this article as class action promoters, perform this role. They are the human actors who employ the other developments discussed above to bring a shareholder class action to fruition. Without class action promoters, the shareholder class action would only be a nascent possibility. Equally, if the substantive causes of action, class action procedure and willing shareholders were not present, the class action promoter would have nothing to organise.

B *The Future of Shareholder Class Actions*

This article has explained why shareholder class actions are now part of the Australian legal landscape. The next step is to ask whether this is a positive or negative development especially as, having identified the above factors, it is possible in many cases to reverse them if desired. Equally, shareholder class actions can be further promoted as shown by the discussion in relation to causation and costs orders. The substantive causes of action and class action procedure are, after all, creations of the Australian Parliament. It is too early to reach a definitive view on the utility of shareholder class action, but there is a dialogue that needs to continue. The remaining section of this article seeks to start that dialogue.

Shareholder class actions may be advocated on the basis that they promote corporate governance and the efficiency of the market by allowing for the enforcement of statutory requirements such as continuous disclosure and prohibitions on misleading conduct.²³³ Further, shareholders who have suffered losses as a result of a corporation's conduct can be compensated, which otherwise would not occur as the cost of litigating would far outweigh any recovery.²³⁴ The traditional rationale of access to justice for class actions applies to the shareholder class actions, but with a public benefit rationale added. The

232 See, eg, Marcus Priest, 'Regulation Call Follows Funder's Win', *The Australian Financial Review* (Sydney), 27 October 2006, 60, reporting that litigation funders had received payments of \$16.6 million for an outlay of just over \$6 million; and Boxsell, above n 206, 52, reporting that IMF Australia would generate about \$37 million revenue from the Aristocrat class action settlement (of which \$22 million would be profit), that it had drastically increased its reliance on class actions and, for the 2008 financial year, had increased its net profit 188 per cent to \$17.2 million.

233 Spender, above n 175, 127; Ben Slade and Juliana Tang, 'Shareholder Class Actions – a Mechanism to Encourage Corporate Responsibility' (2005) 70 *Precedent* 4; Murphy and Cameron, above n 166, 404–5.

234 See *Carnie v Esanda Finance Corporation Ltd* (1995) 182 CLR 398, 429–30; and Donnan, above n 11, 84.

public benefit in enforcing Parliament's statutory requirements has seen the class action promoter referred to as the 'private attorney general' who seeks out contraventions and ensures they do not go unnoticed, leading to greater deterrence.²³⁵ As contraventions become more likely to result in litigation and its related costs, including payment of compensation and reputational effects, corporations will take greater care not to contravene the law.²³⁶ The shareholder class action may also be seen as a way to level the playing field by allowing shareholders to combine to seek a remedy from a corporation that individually they could not match resources with.²³⁷

The above advantages must be weighed against concerns such as the rise of a litigious mind-set within the Australian community due to litigation being seen as a first resort for resolving disputes.²³⁸ Further, the rise of litigiousness flows from the privatisation of regulation where class action promoters seek compensation for disgruntled shareholders more frequently and for greater amounts than ASIC. Self-help through litigation is growing as the regulator is portrayed as being less effective in securing recompense.²³⁹ However, the regulator has a broader range of considerations than just compensating those who have suffered losses.²⁴⁰ The regulator has to consider when and how to use enforcement to punish, educate and compensate, consistent with the efficient use of public funds. Sometimes that may mean seeking less compensation to encourage cooperation with a change to business practices or because the additional costs of having to litigate do not achieve more meaningful levels of education about the operation of a particular law.²⁴¹ The shareholder class action can interfere with the regulator's ability to

235 See Deborah R Hensler et al, *Class Action Dilemmas – Pursuing Public Goals for Private Gain* (2000) 69–72.

236 Australian Broadcasting Corporation, 'Aristocrat Agrees on \$145m Settlement', *Lateline Business*, 28 August 2008 <<http://www.abc.net.au/lateline/business/items/200808/s2349645.htm>> at 8 September 2008, where the Aristocrat settlement was described by the lawyers for the applicant as 'send[ing] a clear message to corporate boardrooms around Australia, ... if you are going to mislead your shareholders, if you choose to mislead the share market ... you are taking a real risk'.

237 F G Hawke, 'Class Actions: the Negative View' (1998) 6 *Torts Law Journal* 1, 1; Bruce Hay and David Rosenberg, "'Sweetheart" and "Blackmail" Settlements in Class Actions: Reality and Remedy' (2000) 75 *Notre Dame Law Review* 1377, 1380; Webb, above n 228, 17.

238 See Beth Quinlivan, 'Investors Revolt', *Business Review Weekly* (Australia), February 2006, 14, revealing that one of the first responses of shareholders to a profit downgrade was 'to investigate mounting a shareholder class action against the company'; Ferguson, above n 2, 17: 'The upshot is that any company that suffers a downgrade without a proper announcement is at risk of being sued'; and Australian Broadcasting Corporation, above n 236, where the Aristocrat settlement was described by the Australian Shareholders Association as 'a big win for shareholders. A few years ago something like this wouldn't have happened. But now shareholders are being more activist, being more critical of their companies and taking to the courts when necessary'.

239 See Collett, above n 29, 8; Robert Harley, 'ASIC Needs to Get Serious About Protecting Investors', *The Australian Financial Review* (Sydney), 30 May 2007, 50; and Marsha Jacobs, 'ASIC too Slow to Salvage Victims', *The Australian Financial Review* (Sydney), 22 January 2008, 8.

240 See *ASIC Act* s 1(2); Farid Assaf, 'What will Trigger ASIC's Strategies?' (2002) 40(4) *Law Society Journal* 60, 61; and Berna Collier, 'The Role of ASIC in Corporate Governance', *Corporate Governance Summit 2002*, 27 November 2002, 67.

241 Harry Kalven Jr and Maurice Rosenfield, 'The Contemporary Function of the Class Suit' (1940–41) 8 *University of Chicago Law Review* 684, 719.

coax cooperation as the corporation may ultimately not reduce its costs if regulatory action will be followed by private litigation. The corporation therefore has an incentive to fight rather than cooperate. Moreover, this public/private enforcement debate needs to consider whether the consumer protection model for the securities markets is a sensible approach. Shareholding has become a consumer activity but the over-enforcement (if that were to occur) of a central regulatory mechanism such as the continuous disclosure regime could see corporations take a defensive approach to disclosure, whereby the market is flooded with information, some insignificant, some indefinite and some incomplete. A defensive approach to disclosure may undermine the objectives of an informed market or harm the commercial interests of the disclosing entity.

The utility of compensation generally goes unquestioned. When the focus is on publicly listed corporations with diversified shareholders, the payment of compensation may be a ‘pocket shifting’ exercise where the shareholders who traded are paid by the shareholders who did not but with large transaction costs, being legal fees and the class action promoter’s share of any recovery.²⁴² A diversified shareholder, such as an institutional investor is equally likely to be the shareholder who traded as the shareholder who did not trade over the long-term, so that their welfare is not improved. Indeed, in a single case an institutional investor may have bought within and outside the group period so that they compensate themselves.²⁴³ However, if litigation takes place and the institution does not participate, then they lose as they pay compensation but do not receive any.

The above analysis may be read as meaning that non-diversified shareholders – usually small shareholders – would make a worthwhile recovery through a shareholder class action as they are unlikely to be both within and outside the group definition in any single case nor in a number of cases over time. However, as small investors usually do not trade actively, but rather ‘buy and hold’, it is most likely that they will buy the shares before any contravention (therefore not purchasing as a result of a contravention) and will still be holding them once the contravention comes to light. Consequently, the small shareholder will only fund, but not participate in, a settlement or judgment.²⁴⁴

The growth of shareholder class actions also carries with it a risk that, as class action promoters (and their shareholders where they are incorporated) only profit when there is litigation to be conducted, less meritorious cases may be commenced. Indeed, it is likely that the class action promoter will have a much larger financial stake in the outcome of the litigation than any single group member. Further, it may be that it is the class action promoter who controls the litigation rather than shareholders, albeit subject to judicial supervision. In the

242 Committee on Capital Markets Regulation, *Interim Report of the Committee on Capital Markets Regulation* (2006) 79 <http://www.capmktreg.org/pdfs/11.30Committee_Interim_ReportREV2.pdf> at 6 September 2008; Jackson and Roe, above n 117; Travis Souza, ‘Freedom to Defraud: Stoneridge, Primary Liability, and the Need to Properly Define Section 10(B)’ (2008) 57 *Duke Law Journal* 1179, 1201–37.

243 Legg, above n 33, 482 and Souza, above n 242.

244 Coffee, above n 148, 1559–60.

United States, one of the main concerns about shareholder class actions was that because it could impose substantial costs on the corporation that could not be recovered, there was an incentive to settle, even if the case had a low chance of success.²⁴⁵ The ‘strike suit’, as it became known, was feasible because in the United States each party bears its own costs.²⁴⁶ The Australian costs regime, where the loser pays, is thought to be a deterrent to strike suits. However, a successful company will not recover all of its direct costs, let alone any of its indirect costs such as lost management time, so that strike suits are possible in Australia.²⁴⁷

A greater exposure of businesses to litigation may create additional costs in terms of compliance and legal costs. This can then harm Australia’s competitive position internationally as businesses choose to locate themselves in a less litigious country.²⁴⁸ Alternatively, it may be argued that stricter enforcement results in greater transparency and integrity of the market.²⁴⁹ The shareholder class action also impacts upon the debate over directors’ duties because liability may be borne by directors, which would add to the factors that may deter qualified persons from putting themselves forward and increase insurance premiums.²⁵⁰ This needs to be balanced against the positive corporate governance effects that may follow.

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- 245 *Blue Chip Stamps v Manor Drug Stores* 421 US 723 (1975), 739–41; Janet C Alexander, ‘Do the Merits Matter? A Study of Settlements in Securities Class Actions’ (1991) 43 *Stanford Law Review* 497, 548–50, arguing that high discovery costs encourage defendants to settle meritless securities litigation. See also *P Dawson Nominees Pty Ltd v Multiplex Limited* (2007) 242 ALR 111 [26]; and Legg and Clark, ‘Curbs Needed on Funded Litigation’, *The Australian Financial Review* (Sydney), 29 November 2006, 55.
- 246 See *Alyeska Pipeline Service Co v Wilderness Society* 421 US 240 (1975), 247: ‘In the United States, the prevailing litigant is ordinarily not entitled to collect a reasonable attorneys’ fee from the loser’.
- 247 See Victorian Law Reform Commission, above n 174, 648, estimating that only 60–70 per cent of costs are recovered. See also, *Taylor v Telstra Corporation Ltd* [2007] FCA 2008 (Unreported, Jacobson J, 13 December 2007); Moran, above n 210, 37; and Matthew Drummond and Marcus Priest, ‘Telstra Settlement Under Court Scrutiny’, *The Australian Financial Review* (Sydney), 16 November 2007, 57, reporting that Telstra Corporation Ltd settled a shareholder class action against it for \$5 million because it was cheaper to settle rather than defend the proceedings.
- 248 See the arguments raised in relation to the United States in *Merrill Lynch, Pierce, Fenner & Smith, Inc. v Dabit* 547 US 71 (2006), 81, discussing the policy behind the enactment of the *Private Securities Litigation Reform Act of 1995*, 15 USC §§ 77z-1-78u-5 (1995); *Stoneridge Investment Partners LLC v Scientific-Atlanta Inc* 128 S Ct 761 (2008), 772; and Michael Bloomberg and Charles Schumer, *Sustaining New York’s and the US’ Global Financial Services Leadership* (2007) United States Senate <http://www.senate.gov/~schumer/SchumerWebsite/pressroom/special_reports/2007/NY_REPORT%20_FINAL.pdf> at 8 September 2008, 73–6.
- 249 Coffee, above n 24, 11.
- 250 See Tony D’Alosio, ‘An Update on ASIC’s Priorities for 2007/2008 and How These Relate to AICD Members’ (Speech delivered at the Australian Institute of Company Directors Luncheon, Sydney, 26 November 2007) 7 <<http://www.companydirectors.com.au/Media/Media+Archive/Speeches+Archive/2007/Tony+D+Aloisio+speech+AICD+Luncheon+Sydney+26+November+2007.htm>> at 8 September 2008, dealing with the impact of regulatory enforcement on directors; Bernard Murphy, ‘Shareholder Class Actions: Are you Vulnerable?’ (2007) 11(5) *Keeping Good Companies* 275, 279; and Neil Young, ‘Has Directors’ Liability Gone too Far or Not Far Enough? A Review of the Standard of Conduct Required of Directors Under Sections 180-184 of the *Corporations Act*’ (2008) 26 *Company and Securities Law Journal* 216, 217.

The shareholder class action has arisen from a convergence of social and legal factors that have taken it from not just obscurity, but non-existence in the Australian legal system, to prominence. The merits of shareholder class action require further evaluation once greater experience with this new form of litigation is obtained. It is not hyperbole to say that we are all shareholders now.²⁵¹ The shareholder class action has the capacity to help but also harm shareholders. Through naming, blaming and claiming, shareholder class actions may promote corporate governance, transparency, accountability and market efficiency. They may also achieve compensation where formerly there was none. Alternatively, the shareholder class action may create an environment characterised by litigiousness and over-deterrence, resulting in corporations unduly focussing on compliance rather than entrepreneurial activity. Further, any compensation is a circular wealth transfer with investors effectively funding their own pay-out but with high transaction costs that give the greatest return to lawyers and litigation funders.

251 This sentiment has previously applied to consumers. See John F Kennedy, 'Special Message to the Congress on Protecting the Consumer Interest' (1962) The American Presidency Project <<http://www.presidency.ucsb.edu/ws/index.php?pid=9108>> at 8 September 2008, where John F Kennedy stated: 'Consumers, by definition, include us all'.