THE AUSTRALIAN ALTERNATIVE: A VIEW FROM ABROAD OF RECENT DEVELOPMENTS IN SECURITIES CLASS ACTIONS

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I INTRODUCTION

The United States has long been the world's home for securities litigation. It has a relatively stable system of securities class actions, developed over almost 50 years of being the irrefutable centre of the international capital market, and many plaintiff-friendly aspects, not the least of which is the fact that each side bears its own litigation costs and attorneys almost universally are compensated through contingency fees or awards from the court from common funds. Due to these benefits, and a heretofore liberality toward hearing claims regarding largely foreign transactions, United States courts have sometimes been seen as regulating the global securities market. However, recent Supreme Court and the Second Circuit Court of Appeals[1] decisions have created significant new barriers to entry for international plaintiffs, especially in the securities context. Should this trend continue, foreign jurisdictions will likely have to bear more of the burden of regulating their own securities markets.

Though Australia's federal class action regime is of remarkably recent vintage, having been established in March 1992,[2] it has developed very quickly into an entrenched aspect of the Australian legal landscape. The total amount of settlements in securities class actions in Australia recently passed the A$1 billion

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1 The Second Circuit is an intermediate appellate level court with jurisdiction over New York City, and therefore is the principal forum for appellate securities litigation.

2 *Federal Court of Australia Act 1976* (Cth) pt IVA ('*FCA IVA*'). In 2000 and 2011, statutory regimes were introduced regulating class actions in the Supreme Courts of Victoria and New South Wales, respectively: Vince Morabito, 'Appeals by Class Members in Australia's Federal Class Actions' (2013) 42 *Common Law World Review* 240, 241.

mark, with A$480 million coming in 2012 alone.[3] As the plaintiffs' bar and funding institutions grow more innovative and push the system's boundaries, and as access to American courts becomes more difficult, the Australian system appears poised to become even more significant in the enforcement of securities laws and in the Australian legal landscape generally. However, as the Australian class action regime takes centre stage, it becomes more important to identify its problems and discover innovative solutions that will increase access to justice in an efficient and administrable way. Although we write as outsiders, familiar with a representative system that has its own failures, some observations and reflections from afar may perhaps highlight some of the critical areas that deserve further attention during this dynamic period in class action law. Furthermore, many of these innovations, especially the emergence of institutional claims for economic harm that has defined recent Australian case development, warrant the attention of class action lawyers across the globe.

The principal barrier to bringing securities class actions is found not in the domain of substantive doctrine, but in the nuts and bolts of how litigation is undertaken, most specifically in the Australian rules governing the funding for litigation. Australia's system of assigning the winner's costs to the loser, and its prohibition on contingency fees for attorneys, make it remarkably difficult to fund class actions, which, given the usual stakes and the resources of the typical defendant, are very expensive. In response, institutional investors in class actions have sprung up, funding litigation and indemnifying the named plaintiffs for any costs should the suit prove unsuccessful, in exchange for a percentage of the settlement or damage award. However, despite the best efforts of creative attorneys, this solution remains incomplete in several crucial ways. Because funders must contract with each individual class member, funded class actions are either closed, which leads to concerns of competitive, redundant lawsuits and disincentivises settlement for defendants, or remain open and class members are incentivised to remain unknown and avoid surrendering a portion of their award to the third party funders. Furthermore, the system of third party funders is simply ill-suited to consumer class actions, given the vast number of people who have been harmed and with whom funders would need to contract, and to bringing meritorious claims with thinner profit margins than third party funders find acceptable.

This article proceeds in six parts, including this introduction. Part II outlines the benefits of the American forum, showing why it has been the home to securities litigation over the past five decades. In Part III we demonstrate that this system has radically changed, and ex post regulation of foreign securities markets is now the province of those foreign countries. If Australia wants its securities markets regulated, enforcement will have to be in Australian courts. In Part IV we turn to the Australian forum, outlining its many benefits. In Part V, we

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3 Moira Saville et al, 'Class Actions in Australia: The Year in Review 2012' (Report, King & Wood Mallesons, April 2013,) 6 <http://www.mallesons.com/Documents/Class_Actions_in_Australia-The_Year_in_Review_2012.pdf>.

discuss its problems, and offer solutions from a comparative perspective. Part VI offers brief conclusions.

II THE ATTRACTION OF THE AMERICAN FORUM

The United States has historically been the home of securities class actions for plaintiffs from across the globe. Indeed, Justice Scalia of the United States Supreme Court once noted his concern that the United States 'has become the Shangri-La of class-action litigation for lawyers representing those allegedly cheated in foreign securities markets.'[4] There are several factors – historical, economic, and legal – that have led to the international focus of securities actions in the United States.

The structure and requirements for class actions in the United States were formalised in the *Federal Rules of Civil Procedure* in 1966, long before Canada and Australia, and certainly before most European countries, many of which continue without formal or developed class action systems.[5] Aside from long being practically the *only* forum where plaintiffs could enjoy the efficiencies of representative actions, American courts have had almost 50 years to develop a mature universe of case law to help make the system more efficient and equitable, and therefore more attractive to plaintiffs.

Additionally, the international capital market is irrefutably centred in the United States, especially in New York. The market capitalisation of the New York Stock Exchange was over US$14 billion as of December 2012, which was over three times as much as the second largest exchange, NASDAQ, which is also based in New York. These two exchanges together have a larger market capitalisation than the next six largest exchanges combined.[6] The United States' disproportionate share of the capital market naturally means that more securities litigation is brought in that forum, which has given courts further opportunity to better develop case law and procedure for securities class actions.

Furthermore, there are several structural reasons for the predominance of the American forum in securities litigation. First, bringing a lawsuit in the United States also entails taking on much less risk than in countries that, as the Supreme Court once put it, 'tax losing parties with their opponent's attorney's fees.'[7] Plaintiffs in American courts need only worry about bearing the costs of their own side of the litigation if they lose. In fact, because the United States permits contingency fees, where attorneys agree to work for a prearranged

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4 *Morrison v National Australia Bank Ltd*, 561 US 247, 271 (2010) ('*Morrison*').

5 See Edward F Sherman, 'American Class Actions: Significant Features and Developing Alternatives in Foreign Legal Systems' (2003) 215 *Federal Rules Decisions* 130 (comparing class action regimes).

6 World Federation of Exchanges, *Monthly Reports: Latest Statistics* <http://www.world-exchanges.org/statistics/monthly-reports>.

7 *Piper Aircraft Co v Reyno*, 454 US 235, 252 (1981).

percentage of the money won or received in settlement, most plaintiffs in large-scale securities cases do not have to worry about paying their own legal fees at all. The United States has a well-developed entrepreneurial plaintiffs' bar, which is both sufficiently resourced and temperamentally disposed to assume the risks of litigation. Class actions can proceed under judicial management, relieving the central need for third party funders and the associated problems of closed classes, competitive actions, and disincentives to settle for defendants.

American courts also have much broader pre-trial discovery rules than other common law countries. Recognising that plaintiffs often will not have access to important evidence without the assistance of the court, and in an effort to ensure that the outcomes of trials depend on the merits of the case rather than on the covert, investigatory abilities of the plaintiff, the *Federal Rules of Civil Procedure* allow for extensive, court-supervised discovery. Document production is not only required from the litigants, but also from third parties.[8] Uniquely among common law countries, the American rules of civil procedure also provide for extensive pre-trial interrogatories and depositions,[9] including depositions of third parties that can be compelled by subpoena.[10] Broad pre-trial discovery allows plaintiffs to initiate proceedings despite having very little evidence, relying on the discovery process to uncover further support.

This system of discovery has the additional benefit for plaintiffs of forcing costs on the defendants. Defendants must pay lawyers to respond to plaintiffs' interrogatories and document requests and to prepare them for and attend depositions. The defendants also bear the cost of finding the documents requested by the plaintiffs, which can sometimes be a huge undertaking. The threat of imposing these costs on the defendants puts the plaintiff in a superior bargaining position in settlement negotiations.

There are also some features of American law that benefit claimants, such as the availability of strict liability, punitive damages, and the guarantee under the Seventh Amendment to the United States Constitution that creates a right to a trial by jury in federal cases (which includes most securities and other mass cases) where the 'value in controversy shall exceed twenty dollars'.[11] Jurors' economic sympathies are often much more plaintiff-friendly than the administrators or judges who decide these cases in other jurisdictions, especially in lawsuits brought by harmed individuals against large, multinational corporations. Correspondingly, in many parts of the United States juries are thought to give larger compensatory damages awards than tribunals in other countries.[12]

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8 See Fed. R. CIv. P. 34.

9 Ibid § 33.

10 Ibid § 30.

11 *United States Constitution* amend VII.

12 See John Y Gotanda, 'Punitive Damages: A Comparative Analysis' (2004) 42 *Columbia Journal of Transnational Law* 391, 421 (analysing the use of punitive damages in the United States, as compared to other common law jurisdictions).

In short, the American system offers plaintiffs an opportunity to bring their claims in courts that have developed a highly sophisticated and comprehensive system for adjudicating class actions and to rely on an extensive discovery period to gather necessary information to which they would not otherwise have access. It offers a higher chance of winning much larger awards at trial, all while risking a fraction of what would be at stake in the same litigation in another forum, if they risk anything at all.[13] All of these factors put plaintiffs in a much stronger position for settlement negotiations. It is no surprise, then, that one British judge wrote that, '[a]s a moth is drawn to the light, so is a litigant drawn to the United States.'[14]

III MORRISON AND NEW BARRIERS TO THE AMERICAN FORUM

Independent of the role of American substantive or even procedural law becoming the law of the globe, the Supreme Court has addressed the risk of the United States becoming a magnet forum for foreign litigants as a central issue in court administration. The risk is that the attractive substantive law, ease of procedure, and the presence of foreign holdings and foreign interaction in the United States will allow United States law to displace other international regimes as the prime regulator of conduct outside the United States.

In a recent landmark decision, the Supreme Court has made it vastly more difficult for international litigants to enjoy the benefits of the United States forum in securities class actions through the stringent application of a canon of statutory interpretation known as the presumption against extraterritoriality, which provides that, '[w]hen a statute gives no clear indication of an extraterritorial application, it has none.'[15] This presumption strives to prevent unintended conflict with foreign nations by requiring that Congress make its intent for a law to apply extraterritorially clear.[16] Taking this precaution not only avoids having courts wrangle with foreign policy, for which they are ill-suited, but also provides a 'stable background against which Congress can legislate with predictable effects.'[17]

A *Morrison v National Australia Bank*

In *Morrison v National Australia Bank*, National Australia Bank ('NAB') shares did not trade directly in the United States, but were only available through the secondary market in American Depository Receipts ('ADRs'), which gave purchasers the right to obtain shares. NAB, however, bought HomeSide Lending,

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13 Though, as discussed above, plaintiffs must also meet the certification requirements of Fed. R. Civ. P 23, and must show *scienter* on the part of the corporate defendants.

14 *Smith Kline & French Laboratories Ltd v Bloch* [1983] 2 All ER 72, 74 (Lord Denning MR).

15 *Morrison*, 561 US 247, 255 (2010).

16 *Kiobel v Royal Dutch Petroleum Co* (Sup Ct, No 10-1491, 17 April 2013) slip op 2 ('*Kiobel*').

17 *Morrison*, 561 US 247, 261 (2010).

a mortgage servicing company headquartered in Florida, which, as was the pattern over the past decade, engaged in considerable mortgage fraud that was in turn securitised. NAB's annual reports, based on HomeSide's accounting, claimed that HomeSide was very successful relying largely on expected profits from servicing loans in the future. However, in 2001, as lower interest rates led to widespread refinancing and early repayment of mortgages that HomeSide serviced, NAB wrote down the value of HomeSide's assets by over $2 billion. The plaintiffs, Australian citizens seeking to represent a class of foreign purchasers of NAB's shares, claimed that executives at HomeSide knowingly manipulated the firm's financial information in order to make it appear more successful, that NAB knew of this practice but did nothing about it, and that this conduct violated §10(b) of the *Securities and Exchange Act 1934* ('the Act'),[18] which prohibits deceptive practices 'in connection with the purchase or sale of any security'.[19]

The critical legal issue in the case was whether this conduct implicated American law. The claimants and the defendant were primarily Australian, yet the fraudulent conduct was undertaken in Florida and was in turn transmitted to the securities markets through New York. The test applied by lower courts, which they had used since the 1960s, was whether Congress would want section 10(b) to apply in this instance based on these facts.[20] The specifics of this inquiry varied over time and by jurisdiction, but generally, courts only had subject matter jurisdiction if they determined that Congress would want the Act to apply either because the offence itself occurred in the United States or because its effects were felt in the United States.[21]

The Supreme Court, through Justice Scalia, rejected this practice entirely and held that district courts have subject matter jurisdiction under a statute giving them jurisdiction over 'all suits in equity and actions at law brought to enforce any liability or duty created by [the *Exchange Act*] or the rules and regulations thereunder.'[22] The real question, then, was whether the Act had been violated.[23] The Court then found that the presumption against extraterritoriality applied, and that, because the Act contains no affirmative indication that it should apply extraterritorially, American law would stand silent before the challenged conduct.[24] As Scalia J colourfully put it, 'the presumption against extraterritorial application would be a craven watchdog indeed if it retreated to its kennel whenever *some* domestic activity is involved in the case.'[25] The Court went on to hold that §10(b) applies only to 'transactions in securities listed on *domestic* exchanges, and *domestic* transactions in other securities,' regardless of where the

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18 Ibid 250–3.
19 15 USC § 78j(b) (1934).
20 *Morrison*, 561 US 247, 255–6 (2010).
21 Ibid 257–8.
22 Ibid 254, quoting 15 USC § 78aa(a) (2012).
23 Ibid 254.
24 Ibid 265.
25 Ibid 266 (emphasis in original).

alleged offence took place or the extent to which the effects were felt in the United States.[26]

B Extraterritoriality in the Wake of *Morrison*

Empirical research on the effects of *Morrison* is still ongoing,[27] and it is too early to predict with too much certainty its long-term effects. However, absent reversal, of which there is no sign, so-called 'f-cubed' cases – involving foreign plaintiffs and foreign issuers of stock that are traded on foreign exchanges[28] – are increasingly unwelcome in the United States. Courts have dismissed them,[29] and plaintiffs' counsel has voluntarily dismissed many others.[30] Furthermore, lower courts have interpreted *Morrison*'s two-pronged test broadly, giving teeth to the previously 'craven watchdog' of the presumption against extraterritoriality.

Under *Morrison*'s first prong, 'transactions in securities listed on domestic exchanges' are expressly categorised as subject to §10(b)(5). However, federal courts in New York have found that alone to be insufficient, dismissing claims under *Morrison* where the purchase occurred abroad,[31] or where the domestic listing was not for trading purposes.[32] The Second Circuit has also strictly interpreted the second prong to narrow access to American courts for foreign

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26 Ibid (emphasis added).

27 A study by PricewaterhouseCoopers, an accounting firm, noted that the number of securities class actions against foreign defendants decreased dramatically from 61 in 2011 to 32 in 2012: PricewaterhouseCoopers, *At the Crossroads, Waiting for a Sign: 2012 Securities Litigation Study* (2013) 9 <http://www.pwc.com/us/en/forensic-services/publications/2012-securities-litigation-study.jhtml>. While 2011 appears to have been an anomaly due to a large number of class actions against Chinese firms, and the number appears to have not diminished dramatically from the longer-term average, the scope of the claims that are filed differ substantially, as has been seen in settlement amounts after *Morrison*: Elaine Buckberg, 'Recent Trends in Securities Class Actions Against Non-US Companies' on Harvard Law School, *The Harvard Law School Forum on Corporate Governance and Financial Regulation* (20 November 2012) <https://blogs.law.harvard.edu/corpgov/2012/11/20/recent-trends-in-us-securities-class-actions-against-non-us-companies/#more-36444>.

28 See Stuart M Grant and Diane Zilka, 'The Role of Foreign Investors in Federal Securities Class Actions' in Practising Law Institute (ed), *Corporate Law and Practice Handbook Series* (2004) 91, 96 (coining the term 'foreign-cubed').

29 See, eg, *Basis Yield Alpha Fund v Goldman Sachs Group*, 798 F Supp 2d 533, 537 (SD NY, 2011); *Mori v Saito* (SD NY, No 10-cv-6465 (KBF), 1 August 2014) slip op 7; *MVP Asset Management (USA) LLC v Vestbirk*, (ED Cal, No 2:10-cv-02483-GEB-CMK, 22 March 2013) slip op 5 (dismissing claim where plaintiff could not or did not show that the relevant purchase was made in the United States); *Elliott Associates v Porsche*, 759 F Supp 2d 469, 473 (SD NY, 2010) (citing *Morrison* and dismissing claims based on alleged fraud involving securities swap agreements and German companies).

30 Peta Spender and Michael Tarlowski, '*Morrison v National Australia Bank Ltd*: Adventures on the Barbary Coast: *Morrison* and Enforcement in a Globalised Securities Market' (2011) 35 *Melbourne University Law Review* 280, 311.

31 *Re Alstom SA Securities Litigation*, 741 F Supp 2d 469, 471–3 (SD NY, 2010) (holding that the mere presence of securities on domestic exchanges, where the purchase occurred abroad, is insufficient to make § 10(b)(5) applicable).

32 *Re Vivendi Universal, SA Securities Litigation*, 765 F Supp 2d 512, 530 (SD NY, 2011); *Re Royal Bank of Scotland Group plc Securities Litigation*, 765 F Supp 2d 327, 336 (SD NY, 2011) 7; *Re Alstom SA Securities Litigation*, 741 F Supp 2d 469, 471–3 (SD NY, 2010); *Sgalambo v McKenzie*, 739 F Supp 2d 453, 487–8 (SD NY, 2010) (all citing *Morrison* while dismissing claims regarding foreign plaintiffs where securities at issue were listed on domestic exchanges but not for trading purposes).

plaintiffs, holding that 'domestic transactions' in securities that are not listed on domestic exchanges occur only 'if irrevocable liability is incurred or title passes within the United States.'[33] Transactions that merely begin in the United States,[34] or that simply involve American plaintiffs, will not get the protection of §10(b)(5).

This new judicial enthusiasm has not been limited to civil complaints under the *Securities Act*. The Second Circuit expanded *Morrison*'s holding to apply to §10(b) in the criminal context, barring the Securities Exchange Commission ('SEC') from enforcing §10(b) where 'the relevant conduct occurred in the territory of a foreign sovereign.'[35] Congress has overturned this result of *Morrison*, explicitly granting federal district courts jurisdiction over actions brought by the SEC alleging violations of §10(b)(5) as long as it involved

> (1) conduct within the United States that constitutes significant steps in furtherance of the violation, even if the securities transaction occurs outside the United States and involves only foreign investors; or (2) conduct occurring outside the United States that has a foreseeable substantial effect within the United States.[36]

However, Congress has given no indication that it intends to undo *Morrison* as it regards private enforcement and civil suits in federal court.

Other commercial laws beyond the *Securities Act* have also felt the bite of the invigorated presumption against extraterritoriality. Citing *Morrison*, the Second Circuit has found that, inter alia, an important conspiracy law that allows a civil cause of action for securities fraud,[37] the law prohibiting fraud in the trade of futures in commodities,[38] and a law barring retaliatory firings for reporting corruption and fraud do not apply extraterritorially.[39]

Perhaps most famously, the Supreme Court and Second Circuit have essentially eviscerated a relatively new interpretation of the *Alien Tort Statute* ('ATS'), a statute dating from 1789 and the founding strokes of the American Republic, which provides that '[t]he district courts shall have original jurisdiction of any civil action by an alien for a tort only, committed in violation of the law of

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33 *Absolute Activist Value Master Fund Ltd v Ficeto*, 677 F 3d 60, 67 (2nd Cir, 2012).

34 See *Plumbers' Union Local No 12 Pension Fund v Swiss Reinsurance Co*, 753 F Supp 2d 166, 178 (SD NY, 2010) (holding that electronic transfers begun in the United States but ultimately finalised abroad are insufficient).

35 *United States v Vilar*, 729 F 3d 62, 74 (2nd Cir, 2013). The defendant was convicted before the provisions of *Dodd-Frank* (see below) allowing SEC enforcement of § 10(b)(5) were passed.

36 *Dodd-Frank Wall Street Reform and Consumer Protection Act*, 15 USC § 77v(c) (2010). This language is strange, as the Court in *Morrison* made it clear that the problem was not one of jurisdiction, but of the scope of the statute. But Congressional intent is clear, and unlikely to be ignored in later suits.

37 See, eg, *Norex Petroleum Ltd v Access Indus Inc*, 631 F 3d 29, 33 (2nd Cir, 2010); *Cedeno v Castillo*, 457 F App'x 35 (2nd Cir, 2012) (each dismissing plaintiff's claim under the *Racketeer Influenced and Corrupt Organizations Act* because the presumption against extraterritoriality applied and there was insufficient domestic activity).

38 *Loginovskaya v Batrachenko*, 936 F Supp 2d 357, 375 (SD NY, 2013) (applying *Morrison* to the *Commodities Exchange Act* and dismissing plaintiff's claim).

39 *Liu Meng-Lin v Siemens AG*, 978 F Supp 2d 325 (SD NY, 2013).

nations or a treaty of the United States.'[40] Beginning in the 1980s, lower courts had interpreted the law to allow for subject matter jurisdiction over wrongs committed abroad when the alleged perpetrators and victims find themselves in the United States.[41] However, in *Kiobel*,[42] a case brought by Nigerian nationals residing in the United States which alleged violations of the law of nations by foreign oil companies in Nigeria, including suppression of protests of oil exploration and production through the use of torture, extrajudicial killing, arbitrary arrest, and a litany of other atrocities,[43] the Court held that the presumption against extraterritoriality applies to the ATS. The statute, though purely jurisdictional, carries the risk of allowing judges to make foreign policy decisions in ways that Congress did not intend, and that nothing in the statute or its history rebuts that presumption.[44] They therefore dismissed the complaint because

> all the relevant conduct took place outside the United States. And even where the claims touch and concern the territory of the United States, they must do so with sufficient force to displace the presumption against extraterritorial application.[45]

The holding in *Kiobel* was arguably ambiguous: it could be read to require *not only* that claims under the ATS be based on wrongs alleged to have been committed in the United States, *but also* that they meet the 'touch and concern' standard for displacing the presumption against extraterritoriality. However, it can also be interpreted to mean, as the *Kiobel* concurrence interpreted it, that claims under the ATS must *either* be based on wrongs alleged to have been committed in the United States *or* meet the 'touch and concern' standard.[46] But the Second Circuit, citing *Morrison*, quickly and conservatively interpreted this decision in *Balintulo v Daimler AG*.[47] *Balintulo* was a consolidated class action brought on behalf of victims of apartheid against subsidiaries of several international corporations that allegedly aided and abetted the South African government in the facilitation of the atrocities of apartheid. Following *Kiobel,* the Second Circuit held that *Kiobel* 'plainly bars common-law suits, like this one, alleging violations of customary international law based solely on conduct occurring abroad', and that the defendants would win on a motion for judgment

40 28 USC § 1350.

41 See International Law Committee of the Bar Association of New York City, 'The Making of *Filartiga v Pena*: The *Alien Tort Claims Act* after Twenty-Five Years' (2006) 9 *New York City Law Review* 249, discussing the first case to use this theory and its impact on subsequent litigation.

42 *Kiobel*, 133 S Ct 1659, 1659 (2013).

43 Ibid 1662–3.

44 Ibid 1669.

45 Ibid.

46 See ibid 1670 (Breyer J concurring) (selectively quoting from the majority opinion and interpreting its holding to be that 'there "is no clear indication of extraterritorial [application] here," where "all the relevant conduct took place outside the United States" and "where the claims" do not "touch and concern the territory of the United States ... with sufficient force to displace the presumption"'). Edited this way, the meaning of the quote is much clearer, though perhaps deceptively so, than it is in the actual Court's opinion.

47 727 F 3d 174, 179 (2nd Cir, 2013) ('*Balintulo*').

on the pleadings.[48] This interpretation makes the 'touch and concern' standard an additional burden, not an alternative path, to overcoming the presumption against extraterritoriality. The plaintiffs in *Balintulo*, like those in *Morrison*, argued that the fact that the United States had an interest in supporting the struggle against apartheid, and that American corporations circumvented sanctions in exporting to South Africa meant that presumption did not apply.[49] However, just as the effects on American investors and the deceptive actions taken in America were insufficient to displace the presumption in *Morrison*, the United States' interest in fighting apartheid and the skirting of sanctions were insufficient to displace it in *Balintulo*. The ATS did not evince a clear intent to apply extraterritorially where America had a strong interest in fighting apartheid, and the skirting of sanctions was not a 'violation of the law of nations' under the ATS.[50]

Post-*Morrison*, when federal courts have been given an opportunity to interpret the Supreme Court's decision to ease or burden foreign plaintiffs' access to American courts, they have almost universally, and enthusiastically, opted for the latter.[51] With recent expansion into areas well outside of securities law, this trend shows no signs of reversal. Foreign countries that once relied on United States federal courts to regulate their securities markets will no longer be able to do so.

However, the United States is famously a country with a longstanding dedication to federalism, and some litigants have attempted to escape *Morrison* by bringing cases under state law. These attempts to circumvent *Morrison*, however, face several significant obstacles, both jurisdictional and prudential. Passed in 1998, the *Securities Litigation Uniform Standards Act* 'SLUSA'[52] bars class actions of 50 or more members 'based upon the statutory or common law of any State' that allege 'a misrepresentation or omission of a material fact in connection with the purchase or sale of a covered security',[53] where covered securities are essentially all those traded on a national stock exchange.[54] This jurisdictional bar was put in place to combat flight to state courts by plaintiffs seeking to avoid federally mandated pleading requirements for securities fraud cases,[55] but is now preventing flight to state courts by plaintiffs seeking to avoid

48 Ibid 182. A motion for judgment on the pleadings is essentially another pre-trial opportunity for a motion to dismiss, but with prejudice, and after the pleadings are closed. It is established by rule 12(c) of the *Fed. R. Civ. P*.

49 *Balintulo*, 727 F 3d 174, 191–2 (2nd Cir, 2013).

50 Ibid 192–3.

51 But see *NML Capital v Republic of Argentina*, 727 F 3d 230 (2nd Cir, 2013) (compelling the Argentinean government to unwillingly pay US$1.33 billion, largely to a hedge fund in the Cayman Islands not only by ordering them to do so, but also by enjoining them from using their money to pay other national debt, and emphasising that intermediate financial actors participating in those payment systems, some of whom are exclusively international actors, are equally, though indirectly, bound through the automatic application of Rule 65(d)).

52 15 USC §§ 77–8 (1998).

53 15 USC § 78bb(f)(1)(A).

54 15 USC § 77r(b)(1).

55 See *Merrill Lynch, Pierce, Fenner & Smith Inc v Dabit*, 547 US 71, 72 (2006) (discussing Congress' motivation for passing SLUSA).

the effects of *Morrison*. For example, in *Re BP plc Securities Litigation*,[56] plaintiffs had made purchases of stock abroad, but the shares were listed, though not traded, domestically. The Federal District Court held that SLUSA barred the state law fraud claims, since they were in connection with securities listed domestically,[57] but *Morrison* barred the federal claims, since the securities were not traded domestically.[58] Despite their objections that the defendants were 'hav[ing] it both ways',[59] the Court essentially closed the doors to *any* American court for these plaintiffs.

Furthermore, the doctrine of *forum non conveniens* offers a prudential, more discretionary avenue for state courts to avoid ruling on claims brought by foreign plaintiffs regarding largely foreign harms. *Forum non conveniens* is a doctrine allowing judges to dismiss a case without prejudice because they believe it is better suited to a different jurisdiction.[60] For example, an intermediate New York state court, which would be the logical venue for many of these securities claims, recently dismissed a securities class action brought against a German car company – a case which had previously been dismissed in federal court after *Morrison* – on *forum non conveniens* grounds.[61] Additionally, the current state of the law suggests that later courts are likely to respect the ruling of the first court and similarly dismiss foreign claims on *forum non conveniens* grounds, forcing plaintiffs to foreign jurisdictions to seek a remedy.[62] Between the jurisdictional bar of SLUSA and the discretionary *forum non conveniens* doctrine, state court actions are unlikely to provide a sufficient alternative to foreign plaintiffs after *Morrison*.

With the portal to the United States narrowing, foreign plaintiffs are looking more to other jurisdictions that also offer the efficiency of representative proceedings.[63] If this trend continues, effective regulation of securities in

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56 843 F Supp 2d 712, 797 (SD Tex, 2012).

57 Ibid 796.

58 Ibid 793.

59 Ibid 797.

60 See generally Donald Earl Childress III, '*Forum Conveniens*: The Search for a Convenient Forum in Transnational Cases' (2012) 53 *Virginia Journal of International Law* 157, 165 (describing the *forum non conveniens* doctrine).

61 *Viking Global Equities LP v Porsche Automobil Holding SE*, 958 NYS 2d 35, 36 (2012); cf *Global Reinsurance Corporation – US Branch v Equitas Ltd*, 18 NY 3d 722, 734 (2012) (New York's highest state court dismissing antitrust claim under state law because, like its federal counterpart, it would 'not reach a competitive restraint, imposed by participants in a British marketplace, that only [incidentally] affected commerce in this country'). But see *Re BP plc Securities Litigation* (SD Tex, MDL No 10-MD-2185, 6 December 2013) (refusing to dismiss a case against British Petroleum on *forum non conveniens* grounds, despite determining that Texas state law required the application of British law, though this is likely due to the large number of other related claims in that court, which would make a division less efficient).

62 See *Exxon Corp v Chick Kam Choo*, 817 F 2d 307, 309 (5th Cir, 1987) *rev'd on other grounds*, 486 US 140 (1988) ('We conclude that the *forum non conveniens* determination in federal court is binding in a subsequent action between the same parties in the nearby state court.').

63 See Linda J Silberman, '*Morrison v National Australia Bank*: Implications for Global Class Action Securities' [2010] *Yearbook of Private International Law* <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1864786> (discussing class action developments in foreign jurisdictions in response to *Morrison*).

jurisdictions outside of the United States will have to occur in the courts of those jurisdictions. While there is something intuitively appealing about this shift in responsibility, it makes examination of those other fora's class action structures a more pressing endeavor.

IV THE ATTRACTION OF THE AUSTRALIAN FORUM

There are several features specific to the Australian forum that make it an attractive site for plaintiffs bringing securities class actions, especially in light of developments in American law. First, substantive Australian law avoids the question of reliance that has been the major contested area of all securities fraud claims in the United States, as most recently seen in *Halliburton Co v Erica John P Fund Inc*,[64] and as will be discussed below. The prohibitions of commercial deceptive conduct in the *Australian Securities and Investments Commission Act 2001* (Cth) ('*ASIC Act*') and the *Corporations Act* 2001 (Cth) ('*Corporations Act*') use an objective standard that does not require that the defendant have known or intended that his or her acts or omissions deceive shareholders.[65] This plaintiff-friendly aspect of the law is especially important because the *Corporations Act* sets a very high bar for corporate disclosure: businesses are required to 'immediately' disclose all information that a reasonable person would expect to have a material effect on the price or value of the business.[66] Should a business fail to meet that requirement, it does not matter whether that failure was intentional for the purposes of finding deceptive conduct under the *ASIC Act* or the *Corporations Act*.[67]

By way of comparison, though the United States also has strict disclosure requirements,[68] the analogous deceptive practices law in the United States[69] has

64 134 S Ct 2398 (2014).

65 *ASIC Act* s 12DA(1) ('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.'); *Corporations Act* s 1041H(1) ('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.')

66 *Corporations Act* s 674(2). For a detailed analysis of the history of the continuous disclosure requirement in Australia, see Merav Bloch, James Weatherhead and Jon Webster, 'The Development and Enforcement of Australia's Continuous Disclosure Regime' (2011) 29 *Company and Securities Law Journal* 253. It is also worth noting that (1) misleading and deceptive conduct; and (2) breach of continuous disclosure obligations are separate causes of action, though they are almost always brought together and depend on the same set of facts and questions of law. See Ross Drinnan and Jenny Campbell, 'Causation in Securities Class Actions' (2009) 32 *University of New South Wales Law Journal* 928, 930–1 (describing these causes of action).

67 This leniency, and its potential for a '20/20 hindsight test', has led to some consternation. See, eg, McCullough Robertson Lawyers, *Australia's Continuous Disclosure System: Clear or Confused?* (6 February 2013) <http://www.mccullough.com.au/page/Media/Continuous_disclosure_guidance_not_completely_clear/>.

68 See, eg, *Sarbanes-Oxley Act of 2002*, 15 USC § 78m (2006) (requiring the 'rapid and current' disclosure of information 'concerning material changes in the financial condition or operations of the issuer, in plain English').

69 15 USC § 78j (1934).

been interpreted by the Supreme Court to require *scienter*, or 'intent to deceive, manipulate, or defraud.'[70] Furthermore, in 1995, Congress passed legislation heightening the pleading requirements for securities litigation, requiring that the plaintiff 'state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind.'[71] The Supreme Court interpreted the 'strong inference' standard to require showing, at the outset of the litigation, that an inference of *scienter* is 'cogent and at least as compelling as any opposing inference of non-fraudulent intent.'[72] Without the benefit of discovery – when plaintiffs might uncover, for example, internal communications evidencing *scienter* – this showing can be difficult or even impossible.[73] The universe of cases that can potentially be brought in Australia is therefore broader than those that can be brought in the United States, at least in theory. This category of cases includes both those in which the defendant did not act knowingly, as well as those in which, though the defendant did act knowingly, the plaintiff cannot convincingly show that *scienter* without engaging in discovery.[74]

The most dramatic advantage for plaintiffs of the Australian class action regime over its American counterpart is that classes in Australia have a much lower initial barrier to overcome. In the United States, the trial court must 'certify' the class before the case can proceed, which involves defining the parameters of the class and class claims, appointing class counsel, and finding that the class meets the comparatively detailed requirements of the *Federal Rules of Civil Procedure*.[75] In order to be certified, the court must find that the class is 'so numerous that joinder of all members is impracticable', that there are questions of law or fact common to the class, that the representative parties have claims and defences typical of the class, and that they and their counsel will adequately protect the interests of the unnamed members of the class.[76] For those classes seeking monetary damages, the court must further find that 'questions of law or fact common to class members predominate over any questions affecting only individual members'.[77] Variance among individual plaintiffs regarding the

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70 *Ernst & Ernst v Hochfelder*, 425 US 185, 193 (1976). It was the desire to avoid this pleading standard that drove plaintiffs into state courts, leading to the *Securities Litigation Uniform Standards Act* discussed above. See above nn 52–5 and accompanying text (describing SLUSA).

71 15 USC § 78u-4(b)(2) (1934).

72 *Tellabs Inc v Makor Issues & Rights Ltd*, 551 US 308, 314 (2007).

73 This heightened requirement in federal court is especially important because the *Securities Litigation Uniform Standards Act of 1998* and the *Class Action Fairness Act of 2005*, which expanded exclusive jurisdiction in federal courts for cases involving national exchanges and eased the process for removal to federal court, respectively, make it difficult to pursue securities litigation in state courts, which might have more lenient standards. See Paul Von Nessen, 'Australian Shareholders Rejoice: Current Developments in Australian Corporate Litigation' (2008) 31 *Hastings International and Comparative Law Review* 647, 661–2 (discussing the impact of these acts).

74 For a discussion of the tests used by different circuits to find *scienter*, see Victoria Su, '*Scienter* after *Tellabs*' (2011) 5 *Brooklyn Journal of Corporate, Financial & Commercial Law* 527.

75 Fed. R. Civ. P. 23(c).

76 Fed. R. Civ. P. 23(a).

77 Fed. R. Civ. P. 23(b)(3).

relevant facts or in the extent of the harm suffered is grounds for rejection of class certification, even if there is substantial overlap on many issues.[78]

In Australia, however, there is no explicit certification process; plaintiffs can simply bring suit as a class, defining the parameters of the class themselves, and the onus is on the defendant to show that the case should not proceed as a class action, either because it does not meet the threshold statutory requirements,[79] or because the class action form is less efficient than individual claims would be.[80] Furthermore, the statutory requirements allow for significantly broader classes in Australia: as long as seven or more persons have claims against the same person, those claims 'are in respect of, or arise out of, the same, similar or related circumstances', and they give rise to 'a substantial common issue of law or fact', the class action can commence.[81] Australia puts no restrictions at all on who can serve as the named plaintiff or class representative, as long as they fall into the category outlined above.

The statute clarifies the 'relatedness' requirement by noting that the proceeding can commence regardless of whether it concerns separate contracts, transactions, acts, or omissions by the defendants in relation to individual group members.[82] Courts have interpreted the 'substantiality' requirement to require only common issues 'which are real or of substance,' as opposed to 'with some special significance for the resolution of the claims of all group members.'[83] This broader reading was justified because 'the purpose of the enactment of Part IVA was not to narrow access to the new form of representative proceedings'.[84] To manage the inevitable variance among individual plaintiffs, rather than demand entirely different actions, perhaps with substantial redundancy between them, the Australian statutory regime allows the court to create subgroups for the independent resolution of these issues.[85] These clauses and their interpretations, which suggest allowing broad classes encompassing many individuals with

78 See, eg, *Amchem Products Inc v Windsor*, 521 US 591, 622–4 (1997) (holding that a class of people who were exposed to asbestos by the defendant did not meet the predominance requirement because individual members were exposed to different products at different times and suffered different physical ailments as a result).

79 *Federal Court of Australia Act 1976* (Cth) s 33C.

80 *Federal Court of Australia Act 1976* (Cth) s 33N. See Jasminka Kalajdzic, Peter Cashman and Alana Longmoore, 'Justice for Profit: A Comparative Analysis of Australian, Canadian and US Third Party Litigation Funding' (2013) 61 *American Journal of Comparative Law* 93, 97–8 (discussing requirements of class actions in Australia).

81 *Federal Court of Australia Act 1976* (Cth) s 33C(1).

82 *Federal Court of Australia Act 1976* (Cth) s 33C(2)(b).

83 See Peter Cashman, *Class Action Law and Practice* (Federation Press, 2007) 261–2, quoting *Wong v Silkfield Pty Ltd* (1999) 199 CLR 255, 267 (Gleeson CJ, McHugh, Gummow, Kirby and Callinan JJ) ('*Wong*'); *Silkfield Pty Ltd v Wong* (1998) 90 FCR 152, 167 (O'Loughlin and Drummond JJ).

84 Cashman, above n 83, 261–2, quoting *Wong* (1999) 199 CLR 255, 267.

85 *Federal Court of Australia Act 1976* (Cth) s 33Q.

disparate claims,[86] stand in contrast with the narrowing 'predominance' requirement of the United States regime.

V THE LIMITATIONS OF THE AUSTRALIAN FORUM

In theory, and in promise, the Australian regime provides an inviting forum for the collective resolution of common claims of economic harm. Like many things that offer salvation in theory, the details often tell a confounding tale. In this Part, we use a comparative perspective to evaluate the problems that the loser-pays system and ban on conditional fees create when applied in the class action context, and evaluate how attempts to resolve those fundamental troubles have given rise to their own concerns with which Australian lawyers, policymakers, and courts continue to struggle. We then suggest potential solutions to explore during this dynamic period of class action development and growth in Australia.

A Fraud and the Reliance Requirement

One of the substantive aspects of Australian law that reduces its attraction for plaintiffs is the lack of clarity regarding how a plaintiff can establish causation in a lawsuit alleging either misleading or deceptive conduct, or a failure to comply with continuous disclosure requirements. In order to succeed on these claims, the plaintiff must show that the offending behavior caused their injury, at least in part.[87] While this element is easy enough to prove for an individual plaintiff, the larger the plaintiff class, the more difficult this burden becomes.

Immediately after the introduction of the class action in the United States, courts regularly held that claimants who did not actually hear or read the misleading statement were found not to have relied on it, and therefore could not recover their losses.[88] However, beginning in 1975, and receiving imprimatur from the Supreme Court in 1988 in *Basic Inc v Levinson* ('*Basic*'),[89] courts began accepting a new theory of reliance allowing investors who did not read or hear the misleading statements to nonetheless meet that burden.[90] This expansion is based on the 'Efficient Capital Markets Hypothesis,' known to its devotees as the ECMH, which posits that, in a thick market with multiple transactions, the price of a corporation's stock reflects all publicly available information about that

86 Cf *Philip Morris v Nixon* (2000) 170 ALR 487 (holding that a class action brought by purchasers of tobacco products sold by the defendant who claimed to have relied on misrepresentations in advertising did not meet the 'relatedness' requirement because 'this case involves vastly different forms of advertising by the three respondents over four decades').

87 Drinnan and Campbell, above n 66, 931.

88 Ibid 933.

89 485 US 224 (1988).

90 See ibid (describing the transition in American courts).

corporation.[91] As the Supreme Court held, '[b]ecause most publicly available information is reflected in market price, an investor's reliance on any public material misrepresentations, therefore, may be presumed'.[92] In effect, this 'fraud-on-the-market' theory means that plaintiffs in a class action do not need to demonstrate individual reliance on the misrepresentations of the defendant, which would be an arduous process.[93] *Basic* has been cited almost 17 000 times since 1988[94] and was recently reaffirmed by the Supreme Court,[95] making it a fundamental building block of securities fraud litigation in the United States for the foreseeable future.[96]

Because class actions have almost universally either settled or been dismissed, Australian courts have neither adopted nor rejected the fraud-on-the-market theory of causation.[97] However, some relatively older cases suggest that the current state of the law requires that each individual demonstrate direct reliance.[98] The issue was argued extensively in the 2007 trial of *Dorajay Pty Ltd v Aristocrat Leisure Ltd*, with both sides claiming the support of precedent and making policy arguments in their favor, but the action settled before the Court issued a ruling.[99] Whether to adopt a fraud-on-the-market theory of reliance and causation, and if such an adoption is even possible without amending the statutory regime, remains an issue of intense debate among Australian

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91 See Michael Legg, 'Shareholder Class Actions in Australia – The Perfect Storm?' (2008) 31 *University of New South Wales Law Journal* 669, 679 ('Shareholder') (explaining the ECMH theory).

92 *Basic*, 485 US 224, 247 (1988).

93 There are several important limitations on this presumption. First, it applies only to actions brought under § 10(b)(5) of the *Securities and Exchange Act*, and defendants can rebut the presumption by showing that the plaintiff knew that the statement was false or would have purchased the stock even if he or she had known. The Supreme Court also recently held that the inflated value of the stock, on which the plaintiffs are presumed to have relied, and the subsequent drop in value that constituted the plaintiff's loss, must have been a result of the misrepresentations alleged and not of extraneous factors: *Dura-Pharmaceuticals Inc v Broudo*, 544 US 336 (2005). See also Drinnan and Campbell, above n 66, 931–2 (outlining these limitations).

94 Alison Frankel, 'Time to Undo Fraud-on-the-Market Presumption in Securities Class Actions?' on Reuters, *On the Case* (14 October 2013) <http://blogs.reuters.com/alison-frankel/2013/10/14/time-to-undo-fraud-on-the-market-presumption-in-securities-class-actions/>.

95 *Halliburton Co v Erica P John Fund Inc*, 134 S Ct 2398, 2410 (2014) ('Halliburton has not identified the kind of fundamental shift in economic theory that could justify overruling a precedent on the ground that it misunderstood, or has since been overtaken by, economic realities.').

96 Three justices argued that '[l]ogic, economic realities, and our subsequent jurisprudence have undermined the foundations of the *Basic* presumption, and *stare decisis* cannot prop up the façade that remains': ibid 2418 (2014) (Thomas J dissenting). But three votes do not the law make. The Court did rely on the fact that 'Congress may overturn or modify any aspect of our interpretations of the reliance requirement, including the *Basic* presumption itself', perhaps inviting Congress to do so: at 2411. However, given this Congress's historically impressive inaction, such a drastic measure is extremely unlikely. See Derek Willis, 'A Do-Nothing Congress? Well, Pretty Close', *New York Times* (New York), 29 May 2014, A3 (describing the drop in legislative activity in the 113th Congress).

97 Drinnan and Campbell, above n 66, 928.

98 See Legg, 'Shareholder', above n 91, 681–3 (discussing several Australian cases that give rise to this inference).

99 For a discussion of the arguments made by either side, see Drinnan and Campbell, above n 66, 936–41.

academics.[100] Regardless of the other policy implications, it is clear that the fraud-on-the-market theory makes it easier for securities class actions to proceed, and the lack of such a regime in Australia makes it more difficult.[101]

B The Funding Dilemma

However, the true barrier to the Australian forum for plaintiffs is not the substantive uncertainty in the law, but rather the simple inability to pay. The effectiveness of any legal regime depends upon whether the incentives justify its use. Here there is just no escaping the problems created in Australia by the combination of loser-pays assignment of costs and the limited nature of the uplift to costs, particularly as regards the attorneys' fees component. The simple fact is that the chief downside to bringing class actions in Australia is the difficulty of funding the litigation. Class actions are by their nature expensive, given the number of claimants and the resources of the typical defendant. While class actions have the effect of leveling the stakes between a repeat actor on the defence side and disparate smaller claimants on the plaintiffs' side, consolidation of all claims into one proceeding raises the stakes and the anticipated costs for all involved. Unless a legal regime engages this central concern in a credible fashion, little will move from the domain of the hypothetical to the real.

It is no coincidence that the class action has had its greatest impact in the United States where each party is responsible for its own litigation costs and there is a longstanding and well-established practice of permitting contingency fees in litigation. The first relieves the named litigant of the prospect of covering the other side's costs in case of an unsuccessful litigation venture, and the second rewards entrepreneurial initiatives by law firms such that contingency fees justify the investment of time and resources in pursuit of a class action. The effect of these two features of American class actions is to take the risk off of the named plaintiffs and place it on the law firms representing the class of passive claimants. Because Australia bars contingency fees, firms were forced to resort to conditional fee arrangements, where the attorneys receive a premium if victorious. However, this premium is unrelated both to the amount of damages

100 Legg, 'Shareholder', above n 91, 682–3 (summarising arguments for the implementation of an American-style presumption, or for doing away entirely with the reliance requirement); cf Drinnan and Campbell, above n 66, 943–7 (arguing that such a policy, aside from being unsupported by law, will result in claimants who did not rely on misrepresentations nonetheless recovering).

101 It should be noted that defendants are equally unsure about the state of the law, so this uncertainty could incentivise settlement on both sides. Ambiguity certainly does not harm the plaintiffs as compared to a clear requirement of direct causation, but ambiguity is certainly more harmful than a presumption of reliance as in the United States.

awarded and to the risk assumed in terms of potential adverse costs, leaving most law firms reluctant to conduct class actions on the basis of a conditional fee.[102]

Another method, which can conceivably work in tandem with a conditional fee arrangement, is for attorneys to organise and contract with class members to fund their own litigation. However, willingness to pay often dissipates over time,[103] and the transaction costs of managing the number of class members required to actually fund the litigation, especially when the individual damages are small, can be prohibitively high.

The principal failing of these methods, however, is that they do not counteract the overwhelming structural disincentives for becoming named plaintiffs present in the Australian class action regime. In class actions, as in most areas of civil litigation in Australia, the loser – specifically the named plaintiff – pays the legal costs of the winning party.[104] Plaintiffs electing to be a representative party, therefore, gain only the goodwill of the unnamed class members, who are asked to risk nothing, but have to assume the full financial risk should the suit be unsuccessful. Under this funding regime, there is no reason for plaintiffs to pursue their claims as the representative party in a class action rather than in an individual lawsuit, where the potential losses would be much smaller but damages would remain the same, or, even better, as an unnamed party in the class action.

C Potential Solutions and the Push towards Third Party Funders

To some extent, the market has stepped in to fill this void. Third party funders do not face the same statutory limits as attorneys and are free to contract with class members for a percentage of the damage award in exchange for funding the litigation and bearing the risk of adverse costs.[105] The contractual arrangement can serve to indemnify the named class representatives against an adverse costs award and allows named plaintiffs to bear no more risk than the rest of the class. Third party funders, beginning slowly in 2001 and then in earnest in 2006 after the High Court declared that third party funding was

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102 Ben Slade, 'The Future of Class Actions' (Paper presented at the University of New South Wales Continuing Legal Education Seminar – Class Actions, Sydney, 25 October 2012). This capacity is further diminished in New South Wales, where attorneys are prohibited from charging an uplift on their ordinary fees of they are successful. The Productivity Commission recently released a report on 'Access to Justice' in which it recommended that 'Australian, State, and Territory Governments … remove restrictions on damages-based billing (contingency fees)': Australian Productivity Commission, *Access to Justice Arrangements*, Report No 72 (2014) 61 <http://www.pc.gov.au/inquiries/completed/access-justice/report> ('Productivity Commission'). Allowing contingency fees would greatly simplify the issue of funding class actions, as law firms with means could fund the litigation themselves on the promise of greater returns, and would do so at little or no cost. Not only would lawyers have incentives not to bring spurious suits, as they would not recover anything, but third party funders currently fill that void anyway. In fact, it is entirely possible that third party funders cost more, taking wealth from the injured parties and their representatives and adding no positive value.

103 Slade, above n 102.

104 See Jarrah Hoffmann-Ekstein, 'Funding Open Classes through Common Fund Applications' (2013) 87 *Australian Law Journal* 331, 333 (describing loser-pays system).

105 Ibid.

permitted, are now the primary manner of funding class action litigation in Australia.[106] At the end of 2011, the leading litigation funder, IMF Australia Ltd (IMF), was funding 27 cases with an estimated value of A$1.6 billion.[107]

Third party funders, conditional fees, and self-funded class actions each have their own problems, and a new jurisprudence is developing around funding litigation to try and resolve them most effectively. The principal problem with all of these possible funding schemes is that they require a contractual relationship between the funders or the attorneys and the class members, wherein the signatories are bound to surrender some of their award – to the third party funder or to the attorneys under a conditional fee regime – or to make ongoing payments toward the litigation if the plaintiffs are funding it themselves. However, plaintiffs who do not sign this agreement do not have to make those payments, and are therefore incentivised to remain in the class but avoid the contractual relationship, thus reaping the full benefits of the representation without having to pay for it. To prevent this 'free rider problem', attorneys and third party funders have experimented with predicating membership of the class on having signed a litigation funding agreement. However, this practice is in conflict with the 'opt out' structure of Australian class actions: everyone who falls into the category defined by the plaintiffs at the outset is a class member, and is therefore bound by the judgment and entitled to a damage award, unless they opt out before a date set by the court.[108] Nonetheless, the Full Federal Court has approved limiting classes in this way, basing their holding on the fact that section 33C allows an individual to start a lawsuit representing 'some or all' of the injured parties.[109] The Court did provide one qualification: the classes must be essentially closed from the outset of the litigation, rather than allowing individuals to 'opt in' once the litigation has begun by signing contracts with the funders.[110]

Like so many solutions, this has given rise to further problems. Most obviously, dividing class actions into a series of closed classes runs directly counter to the goal of class actions to resolve large-scale wrongs efficiently.[111] It is unlikely that a litigation funder will be able to locate and contract with all class members, and they will stop trying as soon as finding more class members is not worth the effort.[112] If enough other potential plaintiffs remain to make a second lawsuit economically viable – which may be easier than in the initial lawsuit, as

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106 Slade, above n 102, 14; Kalajdzic, Cashman and Longmoore, above n 80, 100.

107 Kalajdzic, Cashman and Longmoore, above n 80, 97.

108 This common law norm is incorporated into the statutory regime through *Federal Court of Australia Act 1976* (Cth) s 33E, which says that consent is not necessary for an individual to be a class member, and s 33J, which outlines how individuals can opt out.

109 Hoffmann-Ekstein, above n 104, 338–9 (discussing *Multiplex Funds Management Ltd v P Dawson Nominees Pty Ltd* (2007) 164 FCR 275); *Federal Court of Australia Act 1976* (Cth) s 33C.

110 See Hoffmann-Ekstein, above n 104, 338–9 (discussing *Dorajay Pty Ltd v Aristocrat Leisure Ltd* (2005) 147 FCR 394, which prohibited this type of class). Some members could be added later by court order.

111 Ibid 335 (discussing the goals of representative proceedings).

112 See Michael Legg, 'Reconciling Litigation Funding and the Opt Out Group Definition in Federal Court of Australia Class Actions – The Need for a Legislative Common Fund Approach' (2011) 30 *Civil Justice Quarterly* 52, 61 ('Reconciling') (discussing problems of opt out regimes with third party funding).

the first proceeding can establish liability, or at least provide a map for litigation or settlement negotiation – then enterprising lawyers should initiate such a lawsuit.[113] This duplication of litigation is ongoing in Australian courts, and judicial resources are being wasted either in the litigation of separate proceedings, or in trying to manage the separate proceedings efficiently through stays or consolidations.[114] Furthermore, this regime does not fully resolve the free rider problem, as plaintiffs or third party funders can strategically wait for the initial lawsuit to progress before joining or initiating another that will benefit from the mistakes and achievements of the first. Lastly, defendants are less likely to settle when that settlement will not resolve all potential claims arising out of the cause of action.[115]

Attorneys have tried to mitigate these problems by leaving the class action open and tailoring the terms of settlements to provide appropriate incentives. For example, in *Australian Securities and Investments Commission v Richards* ('*ASIC*'),[116] the class attorneys asked the Court to approve a settlement in which the class members who funded the litigation received 42 per cent of the value of their claims, plus costs, while the class members who did not fund the litigation received only 17.6 per cent.[117] Agreements of this nature would incentivise plaintiffs to fund the litigation, mitigating the free rider problem, and would bind all parties but those who decide to opt out, reducing the likelihood of repeat litigation and increasing the chances of settlement. Nonetheless, the Full Federal Court denied the settlement because they found it not to be 'fair and reasonable to *all* group members'.[118] The Court based its decision on the facts that class members did not have notice of the premium, so neither the funding nor the not-funding group members made informed decisions; that funding class members as a whole received an average 525 per cent return on their investment, which the Court found to be disproportionate to their investment; that the premium was not paid in proportion to the funds provided, either individually or as a whole; and that the firm gave its clients who were not funding class members, and no one else, the opportunity to fund the class *after* the settlement had already been reached.[119] While the Court did not find any inherent unfairness in the basic scheme as outlined above, it did lay out a significant number of hoops, especially

113 Ibid.

114 Ibid (listing instances of multiple closed class actions). Eg, after a court held that certain late fees were unenforceable penalties in a recent, closed class action, the same firm that won that case brought an open class action on that exact same issue. See Australian Associated Press, 'Class Action over Credit Card Late Payment Fees is Australia's Largest', *The Guardian* (online), 11 August 2014 <http://www.theguardian.com/world/2014/aug/12/class-action-over-credit-card-late-payment-fees-is-australias-largest> (quoting the head of Maurice Blackburn's class action practice as saying, 'The February action was for those who signed up. This is for everybody who has not signed up'). While this intra-firm wait-and-see behaviour may be the most optimal for consumers and attorneys who wish to bring the best possible claim, it is a drain on judicial resources as opposed to a single, open class action.

115 Slade, above n 102, 3.

116 [2013] FCAFC 89.

117 Ibid [45].

118 Ibid [42] (emphasis added).

119 Ibid [46]–[52].

notice requirements, through which attorneys seeking to institute such a scheme would have to jump in order to get approval by the court.

Interestingly, however, the Court in *ASIC* went out of its way to suggest that a third party funder would not necessarily have to jump through these same hoops in order to make a profit by funding litigation. First, the funding group members in *ASIC*, the Court noted, did not have any expectation of receiving a premium, 'unlike a commercial litigation funder'.[120] Second, the Court found the attorneys' strategy of fixing the amount of the overall premium by gauging the average sought by third party funders to be 'inappropriate' because the funding class members were 'not in the business of funding litigation to make a profit' and because the amount secured by litigation funders 'is a result of a number of complicated and interconnecting factors', such as the level of risk in the proceedings, competition between funders, negotiations with attorneys, and the funder's overall portfolio.[121] Without these considerations, the percentage selected by the attorneys was deemed too arbitrary. Thus, while the Court has left open the possibility of allowing meticulously constructed settlement agreements, with perhaps impossibly strict notice requirements for plaintiffs who wish to fund their own litigation and make a profit, it explicitly encouraged third party funders' collection of sizeable commissions.

Another recent case decided by the full Federal Court has also had the effect of making it more difficult for class members to fund their own litigation by requiring, for the first time, security payments from individuals funding their own litigation to ensure payment of adverse costs should the class action prove unsuccessful. Three related class actions, which were being managed together, were filed against several companies and their directors that had orchestrated forestry plantation schemes that failed, and the plaintiff class consisted of all individual investors who had been harmed by the companies' alleged failure to disclose the risks of their projects and their corresponding misleading statements regarding the projects.[122] The defendants moved to require the plaintiffs to put forward a security payment of over A$8 million for adverse costs they may incur should they lose the lawsuit[123] – a practice which the courts had instituted in cases with corporate plaintiffs or third party funders, but had yet to be approved in litigation brought by individuals.[124] The trial judge denied the motion because requiring this payment would stifle the litigation; even if the cost of the security were divided among the known plaintiffs, many would be unlikely to participate in the class action either because they would be financially unable to do so, or because the payments would be disproportionate to the amount they stood to

120 Ibid [48].

121 Ibid [52].

122 *Kelly v Willmott Forests Ltd (in liq)* (2012) 300 ALR 675, 683 ('*Kelly*').

123 Ibid 680.

124 Ibid 703. See also Saville et al, above n 3, 17 ('Historically, courts have only been willing to order that plaintiffs pay security for costs in funded representative proceedings.').

gain.[125] Requiring a security payment would, in the view of the trial court, violate the 'traditional rule' that 'natural persons … will not, by reason of impecuniousity [sic] alone, be barred from continuing with proceedings by the granting of an order for security for costs.'[126]

The Full Federal Court, however, overturned this decision, holding that the plaintiffs, who bore the burden of proving that payment of the security would stifle the litigation, had not addressed the possibility of funding on a pro rata basis, given that the known class members included enough individuals of high net worth to make the Court believe there was a 'real capacity to pay.'[127] This decision has the two-fold effect of discouraging class-funded litigation by making it significantly more expensive initially, and exacerbating the free rider problem by giving class members added incentive not to become known. Consequently, the decision encourages third party funded litigation, since the funders would provide the security payment. The Court recognised this possibility, and, in fact, partially rested its reversal on the fact that the plaintiffs had not provided evidence that they could not obtain a third party funder to provide the security, thereby preventing the litigation from being stifled.[128] Though the Court claimed that it was not 'advocating a rule that a step such as the retention of litigation funding should always be taken', it is difficult to read the opinion in any other way.[129]

D Problems with Third Party Funding

Australia's class action system is swiftly becoming a large part of the country's legal and regulatory landscape. This trend is likely to only increase, given the push to foreign courts from the United States due to *Morrison* and its progeny. Furthermore, Australia may become a model for other countries' representative proceeding regimes that may share some concerns about the American model of the entrepreneurial plaintiffs' bar. Third party funding is doubtlessly an innovative response to the problems that loser-pays regimes and the inability of lawyers to be paid on a contingency fee basis pose to the practicability and efficiency of representative proceedings. However, some significant problems remain unsolved, and we must work towards the development of solutions as class actions become more and more important in Australia.

As discussed above, third party funding creates the concerns of closed classes, and consequent competitive class actions and disincentives to settle. Effective court management can minimise the negative effects of these multiple actions in terms of disincentivising settlement. But that management is a drain on

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125 *Kelly* (2012) 300 ALR 675, 701. The court noted that this was especially likely because the more people who opted out of the class action, the higher the burden on the remaining plaintiffs, increasing the likelihood that more opt out, and so on.

126 Ibid 680, 702–3.

127 *Madgwick v Kelly* (2013) 212 FCR 1, 21.

128 Ibid 19.

129 Ibid.

court resources, and the more effective the management is, the more likely it is that the court will have to take an active and constant role.

Another problem is that, while funders increase access to justice by allowing class actions that would otherwise have no source of funding, many meritorious but less profitable claims struggle to be brought. While third party funders can provide another level of screening to prevent unmeritorious actions, most litigation funders look not only to the merits of the action, but also require that there be an expected return on investment of at least 300 per cent, assuming the case runs to judgment.[130] Second, third party funding imposes a significant transactional threshold for litigation. Funders have to be assured not only that they can successfully contract with the likely beneficiaries of the capital investment they deliver, but also that they can capture a significant enough body of claims at relatively low cost outlays. For example, if a large group of claimants had losses amounting to $30 each, and if the cost of securing a contract with each potential claimant were $10, then one third of the potential recovery would be dissipated even before litigation commenced. These added costs, which are unrelated to the merits of the suit, require a higher expected value for funders to be willing to fund a claim and therefore necessarily foreclose some universe of meritorious cases.

Chief among these meritorious actions that are rarely brought are consumer class actions. In order for funders to make a profit, they would need to find and contract with a huge number of plaintiffs *ex ante*, all of whom were subjected to relatively small losses in value.[131] Thus, it is not surprising that in Jane Caruana and Vince Morabito's empirical review of Australian class actions, one finds only 23 class actions from 1994 to 2009 classified as involving a substantive consumer protection claim.[132]

Admittedly, technological developments and the internet have lowered the costs of finding a sufficient number of class members, as law firms can cheaply advertise to a wide audience, and can allow consumers to easily sign up online. Indeed, Maurice Blackburn, one of the leading plaintiff-side class action firms in the country, employed this method in its ongoing litigation regarding credit card fees,[133] signing up over 185 000 Australians online.[134] One could argue that this system simply transfers the costs of notice from being expended after settlement or judgment – as would be necessary in an open class – to before the settlement.

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130 Slade, above n 102, 3.

131 This task is made more difficult by the requirement from *Dorajay Pty Ltd v Aristocrat Leisure Ltd* (2005) 147 FCR 394 that the class be closed at the outset of litigation, before potential class members are entitled to any money. A potential class member is much more likely to go out of their way to join a class when there is already a settlement than when there is only the prospect of a small amount of money some time in the future.

132 Jane Caruana and Vince Morabito, 'Turning the Spotlight on Class Representatives – Empirical Insights from Down Under' (2012) 30(2) *Windsor Yearbook of Access to Justice* 1, 8 <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2099942>.

133 *Paciocco v Australia and New Zealand Banking Group Ltd* [2014] FCA 35.

134 Maurice Blackburn Lawyers, *Bank Fees Class Action* <http://www.mauriceblackburn.com.au/legal-services/general-law/class-actions/current-class-actions/bank-fees-class-action/>.

However, there is an important difference between asking people to take the time – however briefly – to sign up to be in a class action that, maybe, in a few years, might yield them a few dollars, and asking them to sign up because they have *already obtained* a few dollars. The former is simply much less attractive, especially where the potential individual awards at issue are only a few dollars or cents instead of a few hundred dollars, as is at stake in Maurice Blackburn's bank fee litigation. Law firms therefore need to expend proportionally more resources to find a sufficient number of class members *ex ante*, thereby limiting themselves to actions with higher expected values.

A related problem is that third party funding appears to have resulted in a substantial amount of transactional costs, some of it perhaps the result of a relatively new and thin market in which competition has not yet brought down profits.[135] The brute fact, however, is that investing in litigation has been a staggeringly profitable enterprise.[136] IMF funded 130 cases to completion in its first ten years of existence, resulting in A$681 million for plaintiffs; a net income of A$220 million for IMF, with A$105 million for IMF in recovered costs; and another A$105 million for the law firms handling the funded cases.[137] As American observers, we cannot but be struck by the fact that the total paid to funders and attorneys in these class actions, including recuperation of costs, exceeds 40 per cent of the total recovery, a figure that runs more than double the current levels of court-awarded attorneys' fees in United States securities class actions.[138] While some of the recovery goes to insure against an adverse costs judgment – something not required under the American rule of each party assuming its own costs – funders in Australia have paid out virtually no costs judgments, and it is unlikely that the insurance aspect of the funders' share is substantially attributable to the need to immunise the lead plaintiff on costs. Rather, a substantial amount of money, it would seem, is being taken out of the pockets of injured plaintiffs and attorneys who represent them in order to fund the particular form of third party funding in Australia. Over time, and as competition intensifies, no doubt some of the cost excesses will be squeezed out. But still the sums are striking.

The American system offers several potential ways to address these transaction costs. First, where class counsel compensation is set by contract, American law requires that the party with the most at stake select class counsel

135 Productivity Commission, above n 102, 634.

136 See Saville et al, above n 3, 5 (calculating that IMF has made a return on their investment of 304 per cent).

137 Kalajdzic, Cashman and Longmoore, above n 80, 97.

138 See Theodore Eisenberg and Geoffrey P Miller, 'Attorney Fees in Class Action Settlements: An Empirical Study' (2004) 1 *Journal of Empirical Legal Studies* 27, 27 (finding that the mean fee award in common fund cases is 21.9 per cent of the total recovery, with the percentage of the fee award inversely related to the size of the settlement); Brian T Fitzpatrick, 'An Empirical Study of Class Action Settlements and Their Fee Awards' (2010) 7 *Journal of Empirical Legal Studies* 811, 811 (finding that class action lawyers were awarded about 15 per cent of the total settlement amount in all class actions in 2006 and 2007). This percentage is, however, roughly in line with the contingency fee market in the United States: at 830.

and negotiate the terms of the contract. The *Private Securities Litigation Reform Act of 1995* requires that the court select 'the most adequate plaintiff' to represent the class, with a rebuttable presumption that this plaintiff is the party that 'has the largest financial interest in the relief sought by the class'.[139] This plaintiff, 'subject to the approval of the court, select[s] and retain[s] counsel to represent the class.'[140] These plaintiffs thereby gain a significant amount of leverage that they would not have in individual contracts, sparking competition between firms. Applying a similar system to funders in Australia could encourage competition and help hasten the reduction transaction costs that lower class recovery.

Several commentators have noted that a 'common fund' system with judicial supervision, akin to that in the United States, has the potential to solve the free rider and opt out problems.[141] The American *Federal Rules of Civil Procedure* provide that, at the outset of the litigation, the order appointing class counsel 'may include … provisions about the award of attorney fees'.[142] From the outset of the litigation, therefore, courts allow for subtracting the money necessary to litigate the case from the common fund, and thus subtract it pro rata from the class members who benefit from the litigation. At the end of the litigation, the court awards a share of the common fund to the attorneys, either as a percentage of the award or through an hourly rate, depending on a variety of factors.[143] Translating this system to the Australian context would permit class counsel to serve as the entrepreneurial drivers of the litigation, without third party intermediaries. Or, an American-style approach would allow third party funders, who are increasingly just as necessary to the litigation as the attorneys themselves, to continue in that role and be rewarded for their financial and managerial contribution to the litigation, rather than recover exclusively on the contractual basis of the agreement they were able to enter into with multiple individual claimants. Either approach would put the power of class organisation and compensation more firmly in the hands of the supervising court and would give financial rewards based on a different set of factors relevant to incentivising investment in class actions. One prime benefit would be to solve the problems of free riders and closed classes.[144] Also, an active role by the court in setting awards to third party funders may open the door for structuring those awards to incentivise funders to bring cases with smaller profit margins.

Because there is no explicit statute allowing the court to implement a common fund system in the style of the United States, attorneys have attempted to implement a similar regime themselves through leaving the class open but tailoring the settlement agreement to impose costs on all members, as the self-funded class unsuccessfully attempted to do in *ASIC*. Attorneys bringing a

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139 15 USC § 78u-4(a)(3)(B)(iii) (2010).

140 15 USC § 78u-4(a)(3)(B)(v) (2010).

141 See, eg, Hoffmann-Ekstein, above n 104, 343; Legg, 'Reconciling', above n 112, 53; Slade, above n 102, 6.

142 Fed. R. Civ. P. 23(g)(1)(D).

143 See Legg, 'Reconciling', above n 112, 65 (describing these factors).

144 Ibid 69.

lawsuit funded by a third party attempted a similar strategy in *Modtech Engineering Pty Ltd v GPT Management Holdings Ltd* ('*Modtech*'),[145] a recent case decided by the Federal Court. In *Modtech*, the settlement agreement stipulated that the attorneys' costs and a funding commission would be deducted from the entire damage award before individual awards were calculated, meaning that all members, whether they signed contracts with the firm and the funders or not, would have their awards reduced on a pro rata basis.[146] The Court found that this was appropriate as to the attorneys' fees, as the legal costs were fixed and 'should be borne by those who benefitted,'[147] but inappropriate when applied to the funders' commission, as the funders had made a commercial decision to fund the litigation and assume the risk of adverse costs despite the fact that not all of the class members had signed their agreement, and those individuals should not be forced into a contract to which they did not agree.[148] In order to prevent a windfall, the Court suggested that the money that would have gone to the funders instead be divided, pro rata, among the class.[149]

This remedial scheme, however, does not remove the windfall; it merely spreads it out, creating a system where the entire class is incentivised to have the absolute minimum number of its members sign the funding agreement as is necessary to make the litigation possible.[150] In essence, this decision embraced one important tradition in the common law of contracts – privity of contract – at the expense of another, equally important, principle – restitution to prevent unjust enrichment. Whatever the effects of this system, it certainly does not incentivise signing the funding agreement, limiting the utility of this strategy in comparison to a true 'common fund' approach. Furthermore, this strategy, even if the Court had approved it, is lacking because there is no certainty at the outset, before the settlement agreement, that costs will be shared.[151]

One Australian court has an opportunity to change direction, as there is currently a motion pending in the Federal Court for the court to pay the attorneys and funders out of the resolution sum before it is divided among class members.[152] The motion would also require substantial advertising of this arrangement, and permit class members to object to the arrangement before the court.[153] Clearly, the implementation of an analogue to the American system of

145 [2013] FCA 626.

146 Ibid [22].

147 Ibid [24].

148 Ibid [55].

149 Ibid [58].

150 These incentives, however, may not result in action. It would probably be difficult for plaintiffs to organise such a scheme, and doing so would likely cause bad blood between the class members and the funders and attorneys.

151 Though one could imagine, given enough time, a norm developing to make the sharing of costs just as assured as if there were a court order.

152 See *Blairgowrie Trading Ltd*, 'Interlocutory Application', Submission in *Blairgowrie Trading Ltd v Allco Finance Group Ltd*, NSD1609/2013, 8 May 2014, 2 <http://www.mauriceblackburn.com.au/media/2330/interlocutory-application-common-fund-sealed-9-may-2014.pdf>.

153 Ibid 3.

common funds, or discovery of a suitable alternative, is an ongoing project among Australian courts, attorneys, and academics.[154]

VI CONCLUSION

The United States' time as a 'Shangri-la' of securities class actions may be drawing to a close, as the strict application of the presumption against extraterritoriality, as seen in *Morrison* and *Balintulo*, make American courts increasingly unavailable as a safety valve for financial misconduct in other countries. Securities fraud and deceptive practices, however, will not cease out of respect for the new difficulties that plaintiffs may face in bringing suit in the United States. International plaintiffs, therefore, will be forced to look to other judicial systems to fill the gap. Indeed, this shift may have already begun.[155]

Given the many plaintiff-friendly aspects of its substantive and procedural class action law, and the high levels of domestic involvement in the stock market, Australia may emerge as a newly important player in the world of securities class actions. However, the fundamental difficulties that the loser-pays system and the prohibition of contingency fees pose have only been partially solved by the new system of third party funders. There remain several important types of claims for which plaintiffs still do not have access to justice, because the profit margin for their claims is too slim or their damages too small and diffuse. Furthermore, this system has imposed new sets of costs, as defendants are significantly less likely to settle with closed classes when second, third, and fourth classes might be right on their heels, these repetitive lawsuits impose costs on the courts that have to manage them, and third party funders leech large chunks of damage awards and settlements away from those who were injured and their representatives.

In order to continue the remarkable progress that Australia has made as an equitable and efficient forum for class actions, and to brace for the likely influx of securities class actions given the effects of *Morrison*, these costs and shortcomings must be recognised, evaluated, and wrestled with, and creative potential solutions must continue to be tested and adapted by practitioners, courts, and policymakers alike.

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154 For more on potential implementations of a common fund regime, see Legg, 'Reconciling', above n 112, 70–2; Hoffmann-Ekstein, above n 104, 343–7; Slade, above n 102, 6–7.

155 See Silberman, above n 63 (discussing recent class action developments in Canada and the Netherlands in response to *Morrison*).