The Transformation of a Share Price Fall into Litigation - Shareholder Class Actions in Australia

Michael J Legg[+]

Contents

[+] Senior Associate, Clayton Utz. B Com (Hons), M. Com (Hons), LLB (UNSW) and LLM (UC-Berkeley). Solicitor of the Supreme Court of New South Wales and member of the New York Bar. The views expressed in this article are those of the author and not necessarily Clayton Utz.

1. Introduction

Shareholder class actions are a recent but growing phenomenon on the Australian legal landscape. Although 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,[1] it is only since about 2004 that shareholder class actions have been regularly commenced in the Courts. Prominent examples of the shareholder class action are GIO, Telstra, Concept Sports, Harris Scarfe, HIH, the Australian Wheat Board, Multiplex and Aristocrat, and if claims against insolvent corporations by shareholders are included then Sons of Gwalia, Ion and Media World may be added.

The aim of this article is to explain why the number of shareholder class actions is rising. Indeed, the thesis advanced in this article is that there has been a convergence of factors that has, and will continue to, lead to greater litigation in relation to shareholder claims. The rise of the shareholder class action may be explained through a theory of how experiences become grievances which in turn become disputes.[2] The theory of transformation involves three steps: (1) naming - saying to oneself that a particular experience had been injurious; (2) blaming - a person attributes an injury to the fault of another individual or entity; and (3) claiming - voicing a grievance to the person or entity believed to be responsible and seeking a remedy.[3]

The process of claiming from an economics perspective would assume that the person is rational and a claim would only be pursued if the costs of bringing the case were exceeded by the expected recovery.[4] 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.[5] This article argues that costs have been reduced, financing introduced and the prospects of successfully obtaining compensation increased through a number of developments in the Australian legal system. Those 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. Simply put 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".[6] To the

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[1] ALRC, *Grouped Proceedings in the Federal Court*, Report No. 46 (1988) at [65].

[2] William Felstiner, Richard Abel and Austin Sarat, The Emergence and Transformation of Disputes: Naming, Blaming, Claiming (1980-81) 15 *Law and Society Review* 631 at 632. See also Herbert Kritzer, Propensity to Sue in England and the United States of America: Blaming and Claiming in Tort Cases (1991) 18 (4) *Journal of Law and Society* 400 at 401-402 and Austin Sarat, Exploring the Hidden Domains of Civil Justice: "Naming, Blaming and Claiming" in Popular Culture (2000) 50 *DePaul Law Review* 425.

[3] William Felstiner, Richard Abel and Austin Sarat, The Emergence and Transformation of Disputes: Naming, Blaming, Claiming (1980-81) 15 *Law and Society Review* 631 at 635-636.

[4] Frederick Dunbar and Faten Sabry, The Propensity to Sue: Why Do People Seek Legal Actions? (May 2004). NERA Economic Consulting Working Paper at 6 Available at SSRN: http://ssrn.com/abstract=541183

[5] Herbert Kritzer, Propensity to Sue in England and the United States of America: Blaming and Claiming in Tort Cases (1991) 18 (4) *Journal of Law and Society* 400 at 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.

[6] See William Felstiner, Richard Abel and Austin Sarat, The Emergence and Transformation of Disputes: Naming, Blaming, Claiming (1980-81) 15 *Law and Society Review* 631 at 647.

contrary, the shareholder will be encouraged to seek a remedy or more precisely, to execute a retainer and litigation funding agreement.

Economic factors, while very important, do not fully explain why or how injuries become claims so that the academy has looked at psychological and sociological explanations which have recognised the significance of cultural factors, perceptions and personality for blaming others.[7] In the shareholder class action context two cultural or sociological changes have spurred litigation. They are the introduction of consumerism into share ownership and institutional investors taking on the role of class action participant.

This article explains how the above developments in law and society have combined to promote shareholder class actions.

2. A Propensity to Sue

2.1 Investors as Consumers

Consumerism has been defined in a number of ways,[8] but the term is used here in the sense of the movement aimed at educating consumers as to their rights and protecting their interests.[9] Consumerism arose as a reaction to the transformation of society from one based primarily on individual relationships to one in which production, distribution and consumption became a mass phenomena.[10] The consumer concept cuts across individual characteristics and focuses on the common denominator of consumption and how the risk of that activity should be shared with large corporations that were seen as having a much greater degree of power in the consumer-producer relationship.[11]

Consumerism embodies a perception that if a product does not work as expected it is the fault of the manufacturer or seller. Consumerism 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.[12]

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[7] Frederick Dunbar and Faten Sabry, The Propensity to Sue: Why Do People Seek Legal Actions? (May 2004). NERA Economic Consulting Working Paper at 7 Available at SSRN: http://ssrn.com/abstract=541183 , Julie Paquin, Avengers, Avoiders and Lumpers: The Incidence of Disputing Style on Litigiousness (2001) *Windsor Yearbook of Access to Justice* 3 and Dan Coates and Steven Penrod, Social Psychology and the Emergence of Disputes (1980-81) 15 *Law and Society Review* 655.

[8] Consumerism may be defined as equating personal happiness with purchasing material possessions and consumption, as identifying strongly with a particular brand or product, as an economic policy that emphasises consumption.

[9] *The CCH Macquarie Dictionary of Business* (1993) CCH Australia p 128 and Christopher Pass, Bryan Lowes and Leslie Davies, *Economics Dictionary* (2000 3d ed) Harper Collins p 91.

[10] Mauro Cappelletti, Alternative Dispute Resolution Processes Within the Framework of the World-Wide-Access-To-Justice Movement (1993) 56 *Modern Law Review* 282 at 284.

[11] Jason Cornwall-Jones, Breach of Contract and Misleading Conduct: A Storm in a Teacup (2000) 24 *Melbourne University Law Review* 249 at 251 and Iain Ramsay, Consumer Law, Regulatory Capitalism and the 'New Learning' in Regulation (2006) 28 (1) *Sydney Law Review* 9 at 9.

[12] Basil Markesinis, Litigation-Mania in England, Germany and the USA: Are we so Very Different? (1990) 49 *Cambridge Law Journal* 233 at 254 and 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 at 69.

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 and has given rise to the consumer-investor. In *Sons of Gwalia Ltd v Margaretic*, Chief Justice Gleeson observed that:

> 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.[13]

Equally Justice Kirby characterised a purchaser of shares as "a consumer of corporate information".[14] 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".[15]

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;
- 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.[16]

Consequently, share ownership became accessible to, and desirable for, the general public. The Australian Securities Exchange ("**ASX**") reports share ownership figures, which most recently show that

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[13] *Sons of Gwalia Ltd v Margaretic* [2007] HCA 1, (2007) 149 FCR 227 at [18]. See Kirby J at [106]-[107]. See also Stephen Bartholomeusz, "High Court decision opens can of worms for handling large scale insolvencies", The Age, 1 February 2007 p 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.").

[14] *Sons of Gwalia Ltd v Margaretic* [2007] HCA 1, (2007) 149 FCR 227 at [122].

[15] Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into the Structure and Operation of the Superannuation Industry* (2007) at xviii, xx, 8-9 and Ch 6 available at http://www.aph.gov.au/senate/committee/corporations_ctte/superannuation/report/index.htm . See also ASIC Act s 1(2)(b).

[16] See Anthony Perkins and Michael Perkins, *The Internet Bubble* (1999) at 197-208, Geert Lovink, After the Dotcom Crash (2002) 8 (1) *Cultural Studies Review* 130, Michael Duffy, Shareholder Democracy or Shareholder Plutocracy? Corporate Governance and the Plight of Small Shareholders (2002) 25 (2) *UNSW Law Journal* 434 at 436-437, 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 (1) *Sydney Law Review* 99.

38% of the Australian population now owns shares directly and 46% indirectly or directly.[17] These figures understate actual share ownership as they do not include shareholdings via superannuation funds which hold about $447,789 million in Australian equities and unit trusts.[18] The spate of corporate collapses in 2001 then fostered the expectation of protection for Australia's new shareholders and created a political need to respond as shareholders were also voters.[19] More recently, failed investment schemes, have been felt by many Australian consumer-investors.[20]

Consumerism changes the moral colouration of a share price fall or a corporate collapse because it brings new information, understanding and expectations.[21] 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 engaging in investing on the stock market. For example Mr Margaretic, who brought suit against Sons of Gwalia Limited, explained his successful action as "a moral victory. It puts trust into the whole system of buying and selling shares."[22] 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.[23] Little is said about investors needing to assess the risk of an investment or adopt a portfolio approach to investing their funds.[24]

The creation of new causes of action in the *Corporations Act 2001* (Cth) ("**Corporations Act**") and *Australian Securities and Investments Commissions Act 2001* (Cth) ("**ASIC Act**") based on misleading and deceptive conduct and the requirement of continuous disclosure have transformed shareholders views

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[17] 2006 Australian Share Ownership Study, ASX Limited, 2007. The figures are slightly down on the ASX's 2004 Australian Share Ownership Study which found that found that 55% of Australians held shares directly or indirectly. Available at http://www.asx.com.au/about/pdf/2006_australian_share_ownership_study.pdf

[18] The last comprehensive survey of the coverage of superannuation across the Australian population is the Australian Bureau of Statistics publication *Superannuation: Coverage and Financial Characteristics* (catalogue 6360.0) which relates 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 which was about 70% of the total population. Further, for the June Quarter 2007 approximately 48% of total superannuation assets ($447,789 million out of total unconsolidated superannuation assets of $933,400 million) were held in Australian equities and units in trusts. ABS catalogue 5655.0 *Managed Funds*, Australia, June 2007.

[19] Prominent Australian corporate collapses included Pasminco, Ansett, One Tel, Impulse Airlines, Harris Scarfe, and HIH Holdings. See Alan Kohler, 2001: The Year of Corporate Collapses, *The 7 30 Report - Australian Broadcasting Corporation*, Television Program Transcript December 20, 2001 referring to losses of $13 billion. Available at: www.abc.net.au/7.30/content/2001/s445523.htm

[20] Senator Sherry, Senate Standing Committee on Economics, *Official Committee Hansard*, 30 May 2007 at p 96 referring to 19,000 investors losing almost $1 billion.

[21] See William Felstiner, Richard Abel and Austin Sarat, The Emergence and Transformation of Disputes: Naming, Blaming, Claiming (1980-81) 15 *Law and Society Review* 631 at 641.

[22] Andrew Trounson, Historic win for duped investors, *The Australian*, 1 February 2007 available at http://www.theaustralian.news.com.au/story/0,20867,21151270-601,00.html

[23] John Collett, Rise of the vigilante, *The Sydney Morning Herald* (Money), 2 May 2007 at 10.

[24] 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. Colloquially this is described as not putting all of your eggs in one basket. See Edna Carew, *The Language of Money* (3d ed 1996) p 257.

as to who is at fault. The legislation has created a new morality and a sense of entitlement.[25] There are no innocent mistakes anymore because a legislative provision is now breached and fault can be attributed.

2.2 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.[26]

Institutional investors have not traditionally taken part in shareholder litigation, let alone class actions. Institutional investors have not participated for a number of reasons, including the direct costs of paying legal fees and possibly the opponent's costs if they were unsuccessful. There are also indirect costs such as management time, complying with discovery and the impact on business relationships. Management time could be better spent on the main business. The requirement to give discovery may result in not just further costs but the potential disclosure of proprietary information about how investment decisions are made.[27]

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.[28] 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, which is discussed below at section 7.3. 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. 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, the likely recovery, 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 their own pay-out from the litigation.[29] Participation in a class action is not a foregone conclusion for institutional investors but it is now far more likely.

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[25] See William Felstiner, Richard Abel and Austin Sarat, The Emergence and Transformation of Disputes: Naming, Blaming, Claiming (1980-81) 15 *Law and Society Review* 631 at 643.

[26] Ian Ramsay, GP Stapledon, Kenneth Fong, Corporate Governance: The Perspective of Australian Institutional Shareholders (2000) 18 *Company and Securities Law Journal* 110 at 111.

[27] Michael Legg, Institutional investors and shareholder class actions: The law and economics of participation (2007) 81 *Australian Law Journal* 478 at 481 and Lynden Griggs, Institutional Investors and Corporate Governance (1996) 3 *James Cook University Law Review* 44 at 54.

[28] See E Vowles (ed), *Across the Board News* 14 March 2006 CCH p 5 reporting that the chairman of Maurice Blackburn Cashman, Mr Bernard Murphy has 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."

[29] Michael Legg, Institutional investors and shareholder class actions: The law and economics of participation (2007) 81 *Australian Law Journal* 478 at 482.

3. Misleading and Deceptive Conduct

3.1 Background

The provisions prohibiting misleading and deceptive conduct in the securities area are based upon the *Trade Practices Act 1974* (Cth) (**"Trade Practices Act"**) s 52 which has been variously described as the plaintiff's exocet[30], a statutory comet[31] and "one of the most heavily litigated statutory provisions in Australian law".[32] In the early cases on s 52 it was recognised as being "expressed in wide terms",[33] "a comprehensive provision of wide impact",[34] 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".[35]

All of the above statements are aimed at explaining in short-hand 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 Trade Practices Act was extended to securities through judicial decisions, until securities specific legislation was enacted in 1998.[36] The misleading and deceptive conduct prohibition in relation to securities is now embodied in the Corporations Act ss 670A, 728 and 1041H, and ASIC Act s 12DA. However, the extensive case law on s 52, and s 82 which provides the regime for compensation, remain applicable.[37]

3.2 Statutory Causes of Action

The Corporations Act s 1041H prohibits persons from engaging in conduct in relation to a financial product or a financial service that is misleading and deceptive.[38] The ASIC Act s 12DA is in similar

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[30] W Pengilley, Section 52 of the Trade Practices Act: A Plaintiff's New Exocet (1987) 15 *Australian Business Law Review* 247.

[31] See The Hon Mr Justice R S French, A Lawyers Guide to Misleading or Deceptive Conduct (1989) 63 *Australian Law Journal* 250 at 250.

[32] Allan Asher, A "Theory of Everything" for Consumer Protection? (2006) 14 *Trade Practices Law Journal* 110 at 110.

[33] *Hornsby Building Information Centre Pty Ltd v Sydney Building Information Centre Ltd* (1977) 140 CLR 216 at 223.

[34] *Brown v Jam Factory Pty Ltd* (1981) 53 FLR 340 at 348.

[35] *Accounting Systems 2000 (Developments) Pty Ltd v CCH Australia Ltd* (1993) 42 FCR 470 at 503.

[36] For example, s 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 1974* (Cth) 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). Similar amendments were included in state Fair Trading Acts to achieve the same result.

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

[38] 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.

terms to s 1041H but it only relates to "financial services".[39] Both are applicable to securities, including shares.[40] The Corporations Act s 1041I and ASIC Act s 12GF(1) provide that a person who suffers loss or damage by conduct in contravention of s 1041H or s 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, Corporations Act s 1041H and ASIC Act s 12 DA, is very broad but conduct that contravenes a specific provision against misleading and deceptive statements in takeover documents (Corporations Act s 670A) or a fundraising document (Corporations Act s 728), is excluded from the general provisions.[41]

The Corporations Act s 728(1) forms part of Chapter 6D of the Corporations Act that deals with fundraising and provides that a person is prohibited from offering securities under a disclosure document[42] 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.

The Corporations Act s 729 provides a right of compensation in similar terms to Corporations Act s 1041I, that is, a person who suffers loss or damage because an offer of securities under a disclosure document contravenes subsection 728(1) may recover the amount of the loss or damage from a list of specified persons (eg 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, subsection 728(1)).[43] However, unlike s 1041H, a number of defences are available. These include reasonable reliance on information given by some one else, withdrawal of consent, reasonable enquiries and reasonable belief ie due diligence, and lack of knowledge.[44]

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 s 670A may recover the amount of the loss or damage from a list of specified persons (eg the bidder, director of a bidder, the target, director of the target, persons making statements in the documents and a person who contravenes, or is involved in the contravention of, s 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.[45]

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[39] The 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.

[40] See Corporations Act s 764A(1), ASIC Act ss 12BAA and 12BAB, *ASIC v National Exchange Pty Ltd* (2003) 47 ACSR 128 at [2] and *Singh v Singh* [2004] NSWSC 850 at [50].

[41] Corporations Act s 1041H(3) and ASIC Act s 12DA (1A).

[42] Disclosure documents includes prospectuses, short form prospectuses, 'transaction specific' prospectuses, profile statements and offer information statements. See Corporations Act Pt 6D.2, Div 3.

[43] Corporations Act s 729(1).

[44] Corporations Act ss 731, 732 and 733.

[45] Corporations Act s 670D.

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

3.3 Ease of Proof of Statutory Causes of Action

The statutory causes of action for misleading and 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 arrived at by the Court for determining if the conduct is misleading or deceptive.[46] The representative is likely to be typified by an unsophisticated retail level investor or a person without experience in dealing with shares making the likelihood that they may be misled greater.[47]

- silence may amount to misleading and deceptive conduct where the context requires disclosure to avoid a person being mislead or deceived.[48] In the securities context the continuous disclosure regime (discussed below) will frequently create the need to disclose.[49]

- forecasts and forward-looking statements, a staple of takeovers and initial public offerings, are subject to the misleading and deceptive conduct regime.[50] 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.[51] However, the ASIC Act reverses the onus of proof for proving reasonableness by stating that the person is taken to not to have had reasonable grounds unless they adduce evidence to the contrary.[52]

- intention is irrelevant. The provisions are drafted so as to be concerned with consequences not the contravener's state of mind.[53] It is therefore incorrect to refer to the provisions as addressing securities "fraud" as there is no requirement of fraudulent conduct.

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[46] *Campomar Sociedad, Limitada v Nike International Ltd* (2000) 202 CLR 45 at [103]. Followed in *National Exchange Pty Ltd v ASIC* (2004) 49 ACSR 369 at [18]-[19] in relation to s 1041H(1).

[47] *Fraser v NRMA Holdings Ltd* (1995) 55 FCR 452 at 467 and *Downey v Carlson Hotels Asia Pacific Pty Ltd* [2005] QCA 199 at [65].

[48] *Demagogue Pty Ltd v Ramensky* (1992) 39 FCR 31, *Rhone-Poulenc Agrochimie S A v UIM Chemical Services Pty Ltd* (1986) 12 FCR 477 at 490, 504 and 508 and *Henjo Investments Pty Ltd v Collins Marrickville Pty Ltd* (1988) 39 FCR 546 at 557 ("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.")

[49] *GPG (Australia Trading) Pty Ltd v GIO Australia Holdings Ltd* (2001) 117 FCR 23 at [101].

[50] See eg *ASIC v PFS Business Business Development Group Pty Ltd* (2006) 57 ACSR 553 at [365] and [369] and *Downey v Carlson Hotels Asia Pacific Pty Ltd* [2005] QCA 199 at [124]

[51] Corporations Act ss 670A(2), 728(2) and ASIC Act s 12BB(1).

[52] ASIC Act s 12BB(2).

[53] *Hornsby Building Information Centre Pty Ltd v Sydney Building Information Centre Ltd* (1978) 140 CLR 216 at 228 ("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), 234, *Brown v Jam Factory Pty Ltd* (1981) 53 FLR 340 at 348 and *ASIC v Online Investors Advantage Inc* [2005] QSC 324 at [138] dealing with s 1041H(1) of the Corporations Act and s 12 DA(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.[54]

- 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 s 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".[55] This is equally applicable to the Corporations Act and ASIC Act causes of action. Indeed the High Court in *Sons of Gwalia* observed that it was more probable that a shareholder would rely on the statutory causes of action than the tort of deceit.[56] 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.[57] 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*[58] 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.[59]

The vast improvement in a shareholder's prospects of success do still face two constraints, defences to the causes of action based on misleading or deceptive statement in fundraising or takeover documents, and the requirement of causation.

(a) 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 achieves this by immunising conduct that contravenes Corporations Act ss 670A and 728 from the strict liability of s 1041H and s 12DA. This demarcation was introduced to reflect the different philosophies of consumer protection and investor protection. The defences are an acknowledgment that investments provide a return to investors based on their bearing a share of the risks which are intrinsic to financial activity, particularly due to imperfect information. Consequently liability rules should not shift to fundraisers or

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[54] 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.

[55] *Parkdale Custom Built Furniture Pty Ltd v Puxu Pty Ltd* (1982) 149 CLR 191 at 205 quoted with approval in *Campomar Sociedad Limitada v Nike International Ltd* (2000) 202 CLR 45 at [97].

[56] *Sons of Gwalia Ltd v Margaretic* [2007] HCA 1, (2007) 149 FCR 227 at [135].

[57] See W Pengilley, Section 52 of the Trade Practices Act: A Plaintiff's New Exocet (1987) 15 ABLR 247 at 259-260 and The Hon Mr Justice R S French, A Lawyers Guide to Misleading or Deceptive Conduct (1989) 63 *Australian Law Journal* 250 at 250.

[58] *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.

[59] 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 and 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.

those involved in takeovers the investment risk properly accepted by investors in efficient securities markets.[60]

The defences are argued to make the prosecution of those claims more difficult.[61] This should be the case based on the different policy underpinnings. However, the immunity will not apply if the conduct does not fall within the terms of Corporations Act s 670A or s 728, 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 (eg, a large private placement to institutions), but nevertheless it issues an information memorandum.[62] In these situations the immunity does not apply and the company is exposed to liability under s 1041H(1) or s 12DA in respect of its conduct. Equally in the takeovers context s 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 s 1041H and s 12DA to govern any other document or conduct connected with a takeover bid.[63]

(b) Causation

Despite the broad nature of the securities law prohibitions on misleading and deceptive conduct, causation must still be proved.[64] In relation to the Trade Practices Act provision on which the above statutory prohibitions are based an applicant must show either 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.[65] The burden is therefore on the claimant to satisfy the court that he or she relied upon the allegedly misleading and deceptive conduct.[66]

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[60] Fundraising - Capital raising initiatives to build enterprise and employment, Corporate Law Economic Reform Program, Proposals for Reform: Paper No 2, p 41.

[61] Michael Duffy, Shareholder Democracy or Shareholder Plutocracy? Corporate Governance and the Plight of Small Shareholders (2002) 25 (2) *UNSW Law Journal* 434 at 449.

[62] See R P Austin and I M Ramsay, *Ford's Principles of Corporations Law* (LexisNexis 2005 online) at [22.450].

[63] See R P Austin and I M Ramsay, *Ford's Principles of Corporations Law* (LexisNexis 2005 online) at [23.640] and Ian Renard and Joseph Santamaria, *Takeovers and Reconstructions in Australia* (LexisNexis 2005 online) at [927].

[64] 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 at 525 interpreted as expressing the notion of causation. The use of 'because' in s 729 and the use of 'results from' in s 670B also connote causation. See *Wardley Australia Ltd v Western Australia* (1992) 175 CLR 514 at 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 at [234]-[236] and *Trust Company of Australia Ltd v Commissioner of State Revenue* (2006) 62 ATR 258 at [40] ("because of" is an expression of causation).

[65] *Kabwand Pty Ltd v National Australia Bank Ltd* (1989) ATPR 40-950 at 50,378 and *Argy v Blunts & Lane Cove Real Estate Pty Ltd* (1990) 26 FCR 112 at 138.

[66] *Butcher v Lachlan Elder Realty Pty Ltd* (2004) 218 CLR 592 at [37] and *Sutton v A J Thompson Pty Ltd (in liq)* (1987) 73 ALR 322 at 240 "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."

However, it is sufficient to prove that the misleading or deceptive conduct was but one of a number of causes of the damage.[67] 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.[68] 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.[69] Failure to prove causation will mean that a shareholder's claim will fail.[70]

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 means reliance by the entity that suffers loss or damage is not a prerequisite to recovery.[71]

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.[72] The theory presumes that shareholders rely on the integrity of the market price in making their investment decisions so that a misleading statement or omission affects all shareholders through the share price so that individual reliance does not need to be proved.[73] Fraud on the market theory is in essence a short-cut for causation. The various requirements to be able to rely on the presumption and rebut the presumption have been discussed elsewhere.[74] The significance of Australian courts adopting fraud on the market theory or some variation is that the main limitation on the ease of proving the various causes of action discussed above is removed. Consequently shareholders do not need to prove that they relied on a particular misrepresentation but instead they only have to rely on the integrity of the market price.[75]

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[67] *I & L Securities Pty Ltd v HTW Valuers (Brisbane) Pty Ltd* (2002) 210 CLR 109 at [57] ("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.") (italics in original).

[68] *Henville v Walker* (2001) 206 CLR 459 at [61] and [109].

[69] See *Guglielmin v Trescowthick (No 2)* (2005) 220 ALR 515 at [73] 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 at [28].

[70] See *Johnston v McGrath* (2005) 195 FLR 101 at [28]-[29].

[71] 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 at 394 and 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* (September 2007) at 81-83.

[72] *Basic Inc v Levinson* (1988) 485 US 224 at 241-242. The concept of the Efficient Markets Hypothesis is generally traced back to a 1970 academic article, E 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]

[73] D Fischel, "Efficient Capital Markets, The Crash, And the Fraud On The Market Theory" (1989) 74 *Cornell Law Review* 907 at 908.

[74] 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 at 395.

[75] D Fischel, "Efficient Capital Markets, The Crash, And the Fraud On The Market Theory" (1989) 74 *Cornell Law Review* 907 at 908.

Equally class action promoters may argue for a statutory construction of the Corporations Act and ASIC Act that replaces individual reliance with third party reliance via the market. This argument extends the existing case law on the Trade Practices Act s 52 that has found that causation was satisfied when customers were misled by a trader so that they bought more of that trader's product and less of a rival trader's product so that the rival, although not misled, suffered loss or damage as a result of the customers' reliance.[76] 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 that the market did which will be presumed if the market is efficient.

4. Continuous Disclosure

4.1 Background

The main aim of continuous disclosure is to enhance confident and informed participation by investors in secondary securities markets.[77] 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 effect the price of a corporation's securities.[78] Failure to comply was policed by the stock exchange which could make inquiries, issue press releases, suspend or delist companies.[79]

Today the ASX Listing Rules contain several provisions addressing when listed bodies must make immediate disclosure of information to the market.[80] 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.[81]

In 1994 the statutory requirement for continuous disclosure was enacted.[82] The statutory requirements are now in Corporations Act Chapter 6CA which gives the ASX listing rules legislative backing by requiring 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.[83]

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[76] See *Janssen-Cilag Pty Ltd v Pfizer Pty Ltd* (1992) 37 FCR 526 and *Finishing Services Pty Ltd v Lactos Fresh Pty Ltd* [2006] FCAFC 177 at [31].

[77] Companies and Securities Advisory Committee, *Report on an Enhanced Statutory Disclosure System*, September 1991 p 6-7 and Corporate Law Economic Reform Program, *Corporate Disclosure. Strengthening the Financial Reporting Framework*, Paper No 9 (2002) p 129.

[78] Companies and Securities Advisory Committee, *Report on an Enhanced Statutory Disclosure System*, September 1991 p 4 and Parliament of the Commonwealth of Australia, *Corporate Practices and The Rights of Shareholders*, November 1991 p 92.

[79] Parliament of the Commonwealth of Australia, *Corporate Practices and The Rights of Shareholders*, November 1991 p 30.

[80] ASX Listing Rules 3.1, 3.1A and 3.1B.

[81] Josephine Coffey, Enforcement of Continuous Disclosure in the Australian Stock Market (2007) 20 *Australian Journal of Corporate Law* 301 at 313-314.

[82] *The Corporate Law Reform Act 1994* (Cth).

[83] 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.

The entity and any person involved in the entity's contravention may be held liable.[84] A due diligence offence is available for individuals.[85]

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.[86] 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.

4.2 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, the legislature has also provided for private causes of action. The substantive sections described above are financial services civil penalty provisions.[87] Any person who suffers damage in relation to a contravention of a financial services civil penalty provision may apply for a compensation order.[88] 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.[89] Originally a claim for damages was required to at least prove negligence.[90] Pursuant to that standard the first example of civil damages for a failure to disclose took place in 2006.[91] Since the *Financial Services Reform Act 2001* (Cth), which took effect from 11 March 2002, intent or fault has been irrelevant.[92]

Alternatively a person may seek damages pursuant to s 1324(10) when an injunction is sought in relation to a contravention of the Corporations Act or compensation pursuant to s 1325 for a contravention of Chapter 6CA of the Corporations Act. ASIC also has the option of using the infringement notice regime in Pt 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.[93]

It should be noted that the wording of these new causes of action do still require proof of causation. In particular the words "resulted from" have been held to connote causation.[94] Consequently the comments above in section 3.3 about class action promoters seeking to overcome causation requirements through the fraud on the market theory are equally applicable here.

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[84] Corporations Act ss 674(2A) and 675(2A).

[85] Corporations Act ss 674(2B) and 675(2B).

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

[87] Corporations Act ss 1317DA and 1317E.

[88] Corporations Act s 1317J(3A).

[89] Corporations Act s 1317HA(1).

[90] See Corporations Law s 1005 and *Riley v Jubilee Mines NL* (2006) 59 ACSR 252.

[91] Josephine Coffey, Enforcement of Continuous Disclosure in the Australian Stock Market (2007) 20 *Australian Journal of Corporate Law* 301 at 311 citing *Riley v Jubilee Mines NL* (2006) 59 ACSR 252.

[92] See Revised Explanatory Memorandum for the Financial Services Reform Act at [18.3] and *ASIC v Chemeq* (2006) 58 ACSR 169 at [46].

[93] Corporations Act s 1317DAF(6).

[94] *Adler v ASIC* (2003) 179 FLR 1 at [709].

Disclosures that are inaccurate or a failure to disclose when obligated to (ie silence), may also provide key evidence of misleading and deceptive conduct for the purposes of Corporations Act s 1041H and ASIC Act s 12DA. The continuous disclosure regime provides assistance to potential applicants and their lawyers in that representations as to key matters for making investment decisions, such as financial information, must be disclosed.[95] In contrast, the Trade Practices Act provisions on which s 1041H and s 12DA are based do not affirmatively require disclosure, so that they are only activated if an entity decides to speak.[96] Shareholders will receive a stream of representations, anyone of which if it contains 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.[97]

Since at least 1994 non-disclosure or 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 has facilitated claiming.

5. Regulator Assistance for Class Action Promoters

5.1 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 in relation to confidentiality and public comment on its enforcement activities is that it will usually not confirm or deny the existence of an investigation but will generally issue a media release when criminal charges are laid or significant civil or administrative actions which involve public hearings commence and when an outcome is achieved.[98] Further, ASIC will not settle a civil proceeding or enter into an enforceable undertaking on terms that the settlement or parties be confidential.[99] 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.[100] ASIC's policy position is based on two principles, first, being a government body that needs to disclose its enforcement activities so as to be accountable to Parliament and the public, and second, to perform its regulatory functions it needs to inform and educate the industry about the standards it expects and to deter similar conduct.[101]

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[95] Corporate Law Economic Reform Program, *Corporate Disclosure: Strengthening the Financial Reporting Framework*, Paper No 9 (2002) p 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.").

[96] *Fraser v NRMA Holdings Ltd* (1995) 55 FCR 452 at 467 ("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.").

[97] Michael Legg and Dean Jordan, Disclosure Needs Special Care, *The Australian Financial Review*, 14 February 2007 p 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 at 5-6.

[98] See ASIC, *Regulatory Guide 47 - Public Comment*, May 2005 at [RG47.2]-[RG47.10].

[99] ASIC, *Regulatory Guide 47 - Public Comment*, May 2005 at [RG47.11] and ASIC, *Regulatory Guide 100 - Enforceable Undertakings*, March 2007 at [3.6].

[100] ASIC, *Regulatory Guide 100 - Enforceable Undertakings*, March 2007 at [3.7]-[3.9].

[101] ASIC, *Regulatory Guide 47 - Public Comment*, May 2005 at [RG47.12]-[RG47.14] and ASIC, *Regulatory Guide 100 - Enforceable Undertakings*, March 2007 at [3.4].

Nonetheless, ASIC's enforcement steps can act as a class action compass by identifying corporations and officers that may have breached the law. 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 as has occurred in relation to Multiplex. 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.[102] In this instance compensation for shareholders has not prevented the commencement of class action proceedings which relate to a broader period, from 2 August 2004 to 30 May 2005.[103]

In a similar vein, Royal Commissions and the ASX can point class action promoters towards potential class action targets. In the Royal Commission context both HIH and the Australian Wheat Board were followed by shareholder class actions.[104] The ASX can issue a query as to compliance with a listing rule or a price query when there is unusual trading activity or price movements which along with any response can be published to the market.[105]

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, the shareholders themselves who are disgruntled at a corporation's activities will also seek out class action promoters.

5.2 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.[106] ASIC may release transcripts of oral examinations conducted by it under s 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.[107] ASIC considers that the words "related books" refer to documents formally identified and incorporated in the record of examination, and also to documents referred to directly or indirectly in the record which would help people to understand the record.[108] 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.[109] However, for a person contemplating a class action in

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[102] ASIC Media Release 06-443, ASIC accepts an enforceable undertaking from the Multiplex Group, 20 December 2006 (available at http://www.asic.gov.au/asic/asic.nsf/byheadline/06-443+ASIC+accepts+an+enforceable+undertaking+from+the+Multiplex+Group?openDocument).

[103] See *P Dawson Nominees Pty Ltd v Multiplex Limited* [2007] FCA 1061 at [9].

[104] The Hon Justice Owen, *The Failure of HIH Insurance* (2003), *Johnstone v HIH Insurance Limited* [2004] FCA 1414, The Hon Terence Cole QC, *Report of the Inquiry into certain Australian companies in relation to the UN Oil-for-Food Programme* (2006) and *Watson v AWB Ltd* [2007] FCA 1367.

[105] See ASX Listing Rules 18.7 and 18.7A.

[106] ASIC Act ss 19, 29, 30, 33 and 35.

[107] ASIC Act s 25(1). *Boys v Australian Securities Commission* (1998) 26 ACSR 464 at 478 ("The whole point of s 25(1) is to enable the fruits of the ASC's compulsory examination to be made available for use in civil litigation in connection with the subject matter of such examination.").

[108] ASIC, *Regulatory Guide 103* - Confidentiality and Release of Information at [RG103.17].

[109] ASIC Act ss 25(3), 127 and *Johns v Australian Securities Commission* (1993) 178 CLR 408 at 425.

relation to a matter the subject of an examination the former power will be relied upon as the confidentiality regime does not apply.[110] ASIC expects an increase in requests for transcripts and related books as shareholder class actions increase.[111]

ASIC may obtain books under a notice or warrant which ASIC may then use or permit the use of them, for the purposes of a proceeding, including a civil proceeding.[112] 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.[113] 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.[114]

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 s19 examination transcripts and the production of books and documents to ASIC.[115] Not only do plaintiffs obtain information without having to wait for discovery, but they 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.[116]

The s19 transcripts and books may also be obtained through subpoena so that the relevant court's rules would govern the process of obtaining the documents.[117] Thus another avenue exists for obtaining access to very 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.[118] Similarly, in the Multiplex class action leave to issue a

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[110] *Johns v Australian Securities Commission* (1993) 178 CLR 408 at 428.

[111] Jeremy Cooper, Deputy Chairman, ASIC, 'Corporate wrongdoing: ASIC's enforcement role', Keynote address to International Class Actions Conference 2005, 2 December 2005 at 5. Available at: www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/ICAC2005_speech_021205.pdf/$file/ICAC2005_speech_021205.pdf

[112] ASIC Act s 37(4). Proceedings is defined broadly by ASIC Act s 5.

[113] *Walsh v Permanent Trustee Australia Ltd (No4)* (1994) 14 ACSR 653 at 654.

[114] ASIC Act ss 37(7)(a) and (b).

[115] ASIC Act ss 68, 69, *Corporate Affairs Commission of New South Wales v Yuill* (1991) 172 CLR 319, *Australian Securities Commission v Dalleagles Pty Ltd* (1992) 6 ACSR 674 and *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 593 at [35] and [58]. 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).

[116] ASIC Act s 76(1)(d).

[117] *Maronis Holdings Ltd v Nippon Credit Australia Ltd* (2000) 18 ACLC 609 at 615-616 observing that the ASIC Act does not qualify, diminish or remove the Court's powers to allow and control access and inspection.

[118] *King v GIO Australia Holdings Ltd* (2001) 116 FCR 509.

subpoena that sought documents provided by the respondent to ASIC in the course of an investigation, s 19 transcripts and signed or sworn statements from witnesses obtained by ASIC, was granted.[119]

In short, those who may commence a class action are able to 'free ride' on ASIC's evidence collection activities.[120] 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.[121] Prospects are also improved because class action promoters are afforded a forensic advantage in being given access to transcripts of adversarial examinations where the witness is required to answer questions under oath while subject to a strict liability criminal offence for non-compliance.[122] The combination of a reduction in the costs needed to take legal action and a higher likelihood of success makes claiming more likely.

5.3 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.[123] 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.[124] ASIC may also opt for banning orders or jail terms which result in no depletion of potential class action defendants' resources.[125] However, 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".[126] While ASIC and the class action promoters may find themselves competing in relation to cases that ASIC regards as strategically important, limits to regulator

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[119] *P Dawson Nominees Pty Ltd v Multiplex Limited* [2007] FCA 1044 at [10]. ASIC unsuccessfully attempted to deny access to some material based on public interest immunity privilege. See *P Dawson Nominees Pty Ltd v Multiplex Limited* [2007] FCA 1659.

[120] In a similar context see James McConvill and Darryl Smith, Can Minority Shareholders "Free Ride" on ASIC's Civil Penalty Litigation? (2002) 20 CSLJ 302 at 302.

[121] *P Dawson Nominees Pty Ltd v Multiplex Limited* [2007] FCA 1044 at [28]-[30].

[122] ASIC Act ss 19 and 63.

[123] Michelle Welsh, ASIC, civil penalties and compensation orders under the Corporations Act 2001 (Dec 2003 - Feb 2004) *Commercial Law Quarterly* 13 at 21 and 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 at 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?").

[124] See eg ASIC Media Release 06-443, ASIC accepts an enforceable undertaking from the Multiplex Group, 20 December 2006 where a compensation fund for shareholders did not prevent the commencement of class action proceedings which relate to a broader period.

[125] For the range of orders that ASIC has sought see Michelle Welsh, ASIC, civil penalties and compensation orders under the Corporations Act 2001 (Dec 2003 - Feb 2004) *Commercial Law Quarterly* 13 at 28.

[126] Jeremy Cooper, Deputy Chairman, ASIC, 'Corporate wrongdoing: ASIC's enforcement role', Keynote address to International Class Actions Conference 2005, 2 December 2005 at 15. Available at: www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/ICAC2005_speech_021205.pdf/$file/ICAC2005_speech_021205.pdf

resources and the greater incentive for plaintiff's lawyers and litigation funders who make money from a lawsuit suggest that ASIC is unlikely to cover the field.

6. Australian Class Actions

6.1 Pt IVA of the *Federal Court of Australia Act* Regime

The legislation creating group proceedings in Australia at the federal level is Pt 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 hurdles to overcome, complying with the requirements for commencing the proceedings in s 33C, complying with the additional pleading requirements in s 33H and avoiding being discontinued pursuant to s 33N. These requirements have been discussed at length on a number of occasions.[127]

However, certain features need to be highlighted as they are significant in explaining why the creation of a group of litigants is easy to achieve and class action litigation is easy to initiate. The commencement of proceedings is easy because there is no "certification" process that necessitates an applicant demonstrating compliance with s 33C, rather it is up to respondents to challenge the continuation of a class action.[128] The "same, similar or related circumstances" requirement of s 33C(1)(b) has been interpreted liberally so that some relationship must exist but they certainly need not be identical.[129] Indeed the legislation was drafted with the aim of accepting differences as shown by the use of the term related.[130] Equally, the "substantial common issue of law or fact" requirement in s 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' ".[131] The idea is that the common issue not be 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 s 33H which requires the group to be described and the common questions to be specified in addition to compliance with the usual pleading requirements.[132] Although 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.

Under s 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 s 33N being

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[127] See generally, S. Stuart Clark and Christina Harris, Multi-Plaintiff Litigation in Australia: A Comparative Perspective (2001) 11 *Duke J Comp & Int'l L* 289, Rachel Mulheron, *The Class Action in Common Law Systems* (2004), Damian Grave and Ken Adams, *Class Actions in Australia* (2005) and Peter Cashman, *Class Action Law and Practice* (2007).

[128] S. Stuart Clark and Christina Harris, Multi-Plaintiff Litigation in Australia: A Comparative Perspective (2001) 11 *Duke J Comp & Int'l L* 289 at 296 and *P Dawson Nominees Pty Ltd v Multiplex Limited* [2007] FCA 1044 at [18].

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

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

[131] *Wong v Silkfield Pty Ltd* (1999) 199 CLR 255 at 267.

[132] See *Petrusevski v Bulldogs Rugby League Ltd* [2003] FCA 61 at [23] and [38].

frequently invoked by respondents, the Court will strain to use case management techniques to try and assist the proceeding to continue.[133]

In addition to the above requirements, class actions in 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.[134] If a group member falling within the defined class does not opt out then they are bound by the outcome of the proceedings.[135] 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.[136] The opt out approach generally increases the size of class actions by putting the onus on the group member to not participate so that those who are inactive or not aware of the proceedings are included.

However, litigation funders have been pushing for an opt in or limited group class action[137] as the opt out procedure encourages "free-riding".[138] 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.[139] 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.[140] While limited group class actions are usually smaller that traditional opt out class actions as not every one 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 the large holdings such as institutions, as discussed further in section 7.3 below. 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 chose the approach most conducive to their interests.

The legislation also contains requirements for settlement, judgment and notices.[141] The almost identical procedure also exists in Victoria.[142]

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[133] See *Bright v Femcare Ltd* (2002) 195 ALR 574 at [18] (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) and [128].

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

[135] *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.

[136] *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.

[137] 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.

[138] IMF Australia Ltd, *The Shareholder* (August 2006) p 1 and 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").

[139] *Multiplex Funds Management Limited v P Dawson Nominees Pty Ltd* [2007] FCAFC 200 at [44] and [194]-[195]. 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".

[140] *Multiplex Funds Management Limited v P Dawson Nominees Pty Ltd* [2007] FCAFC 200 at [17] and [142].

[141] *Federal Court of Australia Act* ss 33V, 33W, 33X.

[142] Part 4A of the *Supreme Court Act 1986* (Vic).

The above discussion demonstrates that the Australian class action makes the aggregation of numerous securities claims easy to accomplish, even when numerous individual issues exist. The infancy of shareholder class actions means that there has 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.

6.2 Federal Court Rules Order 6 rule 13

Representative proceedings based on the former practices of the Court of Chancery have been recently invoked by class action promoters in protest over not being able to conduct opt in or limited group class actions in the Federal and Victorian Courts.[143] In the shareholder class action context this occurred in the Australian Wheat Board class action.[144] The procedure in New South Wales has also been used by unit holders in a property trust.[145] The limited group approach here, like in Multiplex above, is being driven by class action promoters who wish to ensure that only group members who have entered funding and retainer agreements can participate in the proceedings.

Order 6 rule 13 has been interpreted as being composed of a jurisdictional element, whether there are numerous persons with the same interest in any proceedings so as to allow proceedings to commence, and a discretionary element, whether there are factors which make a representative proceeding undesirable so that a Court should otherwise order.[146]

Typically a proceeding may be commenced if "numerous persons have the same interest" 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 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.[147]

If the Part IV class action 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. 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 will remain as a fall back position for class action promoters. Additionally where other Part IV class action requirements are a hindrance to commencing suit then Order 6 rule 13 may be able to be called upon.

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[143] 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 at 419-420.

[144] See *John Watson and Kaye Watson v AWB Limited*, Federal Court of Australia NSD 659 of 2007, Application filed 17 April 2007. However, in *Watson v AWB Limited* [2007] FCA 1367 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).

[145] *O'Sullivan v Challenger Managed Investments Limited* [2007] NSWSC 383.

[146] *Carnie v Esanda Finance Corporation Ltd* (1995) 182 CLR 398 at 405, 415 and 427 dealing with the equivalent rule in the Supreme Court of New South Wales' former court rules.

[147] *Esanda Finance Corporation Ltd v Carnie* (1992) 29 NSWLR 382 at 388 and 390 and *Fostif Pty Ltd v Campbells Cash & Carry Pty Ltd* (2005) 63 NSWLR 203 at [278].

6.3 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.[148] This approach to costs has frequently been cited as discouraging class action litigation.[149] 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.[150] Similarly in a representative proceeding it is unusual for group members to be liable for costs, although the power to award costs against them has been argued to exist.[151] Consequently, 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.[152] The group may therefore be structured so that it has as a representative a person who has no capacity to pay costs which removes 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 section 7.1 below). 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. This is an order that can be made by the court requiring an applicant or funder to pay into court, or otherwise give security for, an amount equal to the estimated costs of the proceedings. Whilst security for costs are available in class actions, the courts have

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[148] *Ruddock v Vadarlis* (2001) 115 FCR 229 at [11] and *Hughes v Western Australia Cricket Association (Inc)* (1986) ATPR 40-748 at 48,136.

[149] 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 at 160-161 and Peta Spender, Securities Class Actions: A View from The Land of the Great White Shareholder (2002) 31 *Comm. L. World Rev.* 123 at 143 and 160.

[150] *Federal Court of Australia Act 1976* (Cth) s 43(1A) and *Supreme Court Act 1986* (Vic) s 33ZD.

[151] 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 at 420 and *O'Sullivan v Challenger Managed Investments Ltd* [2007] NSWSC 383 at [68]. However, in *Burns Philp & Co Ltd v Bhagat* [1993] 1 VR 203 at 223 it was held that represented parties are potentially liable for costs. Richie's Uniform Civil Procedure NSW at [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 orders costs against an inactive individual person who is within the class of those represented in the proceedings.

[152] *Cook v Pasminco Ltd (No. 2)* (2000) 107 FCR 44 at [30].

been reluctant to make such orders.[153] However an order for security for costs will be made in appropriate circumstances such as against an incorporated organisation.[154]

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 an exception to that general rule based upon the public interest nature of class action litigation.[155] To date such a development has met with little success.[156]

6.4 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.[157]

The pooling of claims means that a claim that may be uneconomic to pursue alone can when combined with other claims become worthwhile pursuing.[158] The class action also allows for the cost of bringing the action to be spread across many claimants giving rise to economies of scale because as the number of group members increases costs increase by a lesser amount.[159] For example, the cost of investigating the merits of a claim is about the same whether there is one claimant or many. The cost of litigating may be reduced. However, when the stakes are increased the case is likely to be harder fought which may create additional costs.[160]

In the area of shareholder claims the class action is an attractive procedural vehicle because many of the claims are small and the class action allows for them to be aggregated to create a single substantial

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[153] See *Bray v F Hoffman-La Roche Ltd & Others* (2003) 130 FCR 317 at [134]-[145] (Carr J) and [250]-[252] (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 and *Nendy Enterprises Pty Ltd v New Holland Pty Ltd* [2002] FCA 550.

[154] See *Tobacco Control Coalition Inc v Philip Morris (Austl) Ltd* [2000] FCA 1404 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.

[155] Julian Donnan, Class Actions in Securities Fraud in Australia (2000) 18 *Company and Securities Law Journal* 82 at 94 and Peta Spender , "Securities Class Actions: A View from The Land of the Great White Shareholder" (2002) 31 *Comm. L. World Rev.* 123 at 144 and 160.

[156] See *Qantas Airways Ltd v Cameron (No 3)* (1996) 68 FCR 367. See more generally *Save the Ridge Inc v Commonwealth* [2006] FCAFC 51 at [6] ("the courts have held that there is no special costs regime applicable to 'public interest' litigation").

[157] *Wong v Silkfield* (1999) 199 CLR 255 at 264 and ALRC, *Grouped Proceedings in the Federal Court*, Report No 46 (1989) at [330] and [336].

[158] See Second Reading Speech by the Attorney-General, Australia, House of Representatives, *Parliamentary Debates* (Hansard), 14 November 1991 at p 3177.

[159] See Second Reading Speech by the Attorney-General, Australia, House of Representatives, *Parliamentary Debates* (Hansard), 14 November 1991 at p 3177.

[160] *Bright v Femcare Ltd* (2002) 195 ALR 574 at [160] referring to interlocutory applications by respondents in class actions increasing costs. See also Justice Kevin Lindgren, Keynote Address - Class Actions and Access to Justice, *International Class Actions Conference 2007*, 25 October 2007 p 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.

claim.[161] 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.[162] 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.[163] In any shareholder class action both small and large claimants may be present 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.[164]

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. Claiming which otherwise would not take place is now able to be pursued.

7. Litigation Funding

7.1 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 (vexatious or oppressive litigation, elevated damages, suppressed evidence, suborned witnesses) for personal gain. 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.[165] It seems likely that maintenance and champerty are obsolete as crimes at common law.[166] 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'.[167]

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[161] Peta Spender, Securities Class Actions: A View from the Land of the Great White Shareholder (2002) 31 *Common Law World Review* 123 at 124.

[162] Michael Legg, Institutional investors and shareholder class actions: The law and economics of participation (2007) 81 ALJ 478.

[163] *P Dawson Nominees Pty Ltd v Multiplex Limited* [2007] FCA 1044 at [24].

[164] See *Mobil Oil Australia Pty Ltd v State of Victoria* (2002) 211 CLR 1 at [183].

[165] *Civil Law (Wrongs) Act 2002* (ACT) s 221; *Maintenance, Champerty and Barratry Abolition Act* 1993 (NSW) 3, 4, 6; *Criminal Law Consolidation Act 1935* (SA) Sch 11 ss 1(3), 3; *Wrongs Act 1958* (Vic) s32 and *Crimes Act 1958* (Vic) s322A.

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

[167] See eg, *Maintenance, Champerty and Barratry Abolition Act* 1993 (NSW) s 6; *Wrongs Act 1958* (Vic) s32 (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.[168] 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.[169] 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.[170]

7.2 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.[171] The High Court held 5 to 2 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.[172] 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 (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.[173] Gleeson CJ and Kirby J agreed with the reasoning of the joint judgment.[174] Callinan and Heydon JJ dissented on this issue.[175] The 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.[176]

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[168] Carman Yung, Litigation funding: officious intermeddling or access to justice? (2005) 15 *Journal of Judicial Administration* 61 at 62 and Vicki Waye, Conflicts of Interests Between Claimholders, Lawyers and Litigation Entrepreneurs (2007) 19 (1) *Bond Law Review* 225 at 297.

[169] Standing Committee of Attorneys-General, *Litigation Funding in Australia* (May 2006) p4 and Vicki Waye, Conflicts of Interests Between Claimholders, Lawyers and Litigation Entrepreneurs (2007) 19 (1) *Bond Law Review* 225 at 252 and 283.

[170] Vicki Waye, Conflicts of Interests Between Claimholders, Lawyers and Litigation Entrepreneurs (2007) 19 (1) *Bond Law Review* 225 at 251 and 297.

[171] (2006) 229 CLR 386.

[172] *Campbells Cash and Carry Pty Limited v Fostif Pty Ltd* (2006) 229 CLR 386 at [84]-[86].

[173] *Campbells Cash and Carry Pty Limited v Fostif Pty Ltd* (2006) 229 CLR 386 at [93].

[174] *Campbells Cash and Carry Pty Limited v Fostif Pty Ltd* (2006) 229 CLR 386 at [1] and [146].

[175] *Campbells Cash and Carry Pty Limited v Fostif Pty Ltd* (2006) 229 CLR 386 at [287].

[176] *Deloitte Touche Tohmatsu v JP Morgan Portfolio Services Ltd* (2007) 158 FCR 417 at [39] (Tamberlin and Jacobson JJ) and [102] (Rares J dissenting but on another issue)

7.3 Litigation Funding Promotes Shareholder Class Actions

Litigation funding is advocated on the basis of providing access to justice, spreading of the risk of complex litigation, improving the efficiency of litigation through introducing commercial considerations that will aim to reduce costs but is also a business aimed at maximising profits.[177] Litigation funding is likely to increase the amount of shareholder class action activity because it makes available the financing needed for identifying and prosecuting potential law suits. 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, ie 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. Shareholder class actions are also attractive because it is easier (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.[178] 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.[179]

Litigation funders are also likely to increase the number and size of shareholder class actions through recruiting institutional shareholders. The driving force behind institutional investors taking an interest in shareholder class actions is litigation funding due to the funders wanting to increase the size of any class and accordingly the size of any recovery from which they can take their fee. 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.[180] Litigation funders can be expected to bring class actions to an institutions notice and make as cogent an argument for participating as possible.

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[177] *Fostif Pty Ltd v Campbells Cash & Carry Pty Ltd* (2005) 63 NSWLR 203 at [100], *QPSX Ltd v Ericsson Australia Pty Ltd (No 3)* (2005) 219 ALR 1 at [54] and Carman Yung, Litigation funding: officious intermeddling or access to justice? (2005) 15 *Journal of Judicial Administration* 61 at 80 ("professional litigation funding is not intended to be altruistic. The overriding objective of the industry is the maximisation of profits.").

[178] The calculation of damages in relation to shares trading on an efficient market at an inflated price is the subject of *Dorajay Pty Ltd v Aristocrat Leisure Limited* NSD 362 of 2004, Federal Court of Australia.

[179] Christopher Webb, A man named sue, *The Sunday Age*, 17 September 2006 p 17 and Vicki Waye, Conflicts of Interests Between Claimholders, Lawyers and Litigation Entrepreneurs (2007) 19 (1) *Bond Law Review* 225 at 251 and 280-282.

[180] Michael Legg, Institutional investors and shareholder class actions: The law and economics of participation (2007) 81 ALJ 478 at 485.

8. Conclusion

The rise of the shareholder class action is explained through the use of the transformation theory. Shareholder class actions present 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:

(a) Willingness to Blame

There has been a change in the shareholder's mindset 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 not some external force of nature.[181] The Corporations Act and ASIC Act perform that role by assigning responsibility. The legislation has created a new morality.[182] 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.

(b) 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 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.

(c) 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 less. 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 taking steps to streamline this aspect of the litigation.

(d) 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-

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[181] Austin Sarat, Exploring the Hidden Domains of Civil Justice: "Naming, Blaming and Claiming" in Popular Culture (2000) 50 *DePaul Law Review* 425 at 434 and 436

[182] See William Felstiner, Richard Abel and Austin Sarat, The Emergence and Transformation of Disputes: Naming, Blaming, Claiming (1980-81) 15 *Law and Society Review* 631 at 643.

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.