

The Rise of Corporate Class Actions in Australia - An American Style Litigation Explosion?

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On 30 August 2006, the High Court of Australia delivered its judgment in the matter of *Campbells Cash and Carry Pty Limited v Fostif Pty Ltd* [2006] HCA 41. The decision confirms the legality of litigation funding in Australia at least in those jurisdictions in which it was previously a tort and a crime.

This article examines the consequences of the *Fostif* decision in the context of shareholder class actions, and looks at whether Australia is now facing an American style litigation explosion.

Litigation funding and the *Fostif* case

Litigation funding arrangements have traditionally been restricted by the law of maintenance (inciting another to bring an action) and champerty (entering into a financial arrangement regarding the action with the maintenee).

Prior to the *Fostif* case, litigation funding arrangements were fraught with uncertainty. Proponents of such arrangements assert that they facilitate access to justice, whilst opponents contend that they encourage trafficking in litigation. There have been more than 20 court challenges to litigation funding arrangements over the last 8 years [See "Litigation funding in Australia", Discussion Paper, Standing Committee of Attorneys-General, May 2006].

The *Campbells Cash and Carry Pty Limited v Fostif Pty Limited; Australian Liquor Marketers Pty Limited v Berney* [2006] HCA 41 decision (the *Fostif* decision) has dispelled the uncertainty surrounding litigation funding arrangements in Australia.

The case was brought by a group of tobacco retailers, to recover licensing fees paid to tobacco wholesalers under the state and territories tobacco licensing schemes. The tobacco licensing schemes were declared invalid by another decision of the High Court in *Ha v State of New South Wales* (1997) 189 CLR 465. The *Fostif* proceedings were brought as 'representative proceedings' under the Supreme Court Rules of NSW.

The case was funded for the tobacco retailers by a litigation funding firm called Firmstones Pty Ltd on the basis that it would receive one third of any proceeds of the litigation received by the tobacco retailers, in addition to the benefit of any favourable costs order received by them.

The defendants on appeal in *Fostif* submitted that a number of factors ought to be taken into account when considering whether Firmstones' litigation funding arrangements were an abuse of process or contrary to public policy. These factors included:

- The seeking out of claimants by Firmstones constituted "officious intermeddling".
- The degree of control that Firmstones would have over the proceedings.
- The litigants' interests being "subservient" to those of Firmstones.
- Firmstones bought rights to litigate for profit and was therefore "a speculative investor in other persons' litigation".

The High Court rejected these arguments and found that in states that have abolished the crimes and torts of maintenance and champerty, no public policy considerations arise in relation to the private funding of litigation. In other words, the Court found that litigation funding is not in itself an abuse of process or contrary to public policy. The only question of public policy that may arise is

in the enforcement of the litigation funding agreements themselves.

The High Court, however, ordered that the case could not proceed as a representative proceeding because at the time the proceedings were commenced, numerous persons, being the tobacco retailers, did not have the same interests in the proceedings, as was required by the rules of the NSW Supreme Court on representative proceedings. This is likely to discourage those retailers with small claims from pursuing their claims individually.

Implications of *Fostif*

The *Fostif* decision is of concern for defendants as it is likely to lead to an increase in the incidence of shareholder litigation and funded litigation generally.

It has even been reported that superannuation funds and other institutional investors would now consider participating in and pursuing shareholder class actions as a result of the decision [See *Australian Financial Review*, 28/08/06, page 3].

However, it is also likely that *Fostif* will open the door to innovative business opportunities for Australian corporations and litigation funders.

The decision may also have the effect of encouraging early settlement of cases and reducing delays by removing a factor of uncertainty that has been the subject of many interlocutory applications by defendants up to now.

Why has there been a rise in shareholder class actions?

In recent times, a number of new class actions and anticipated new class actions have been announced by shareholders against corporations such as Telstra, Aristocrat, Multiplex, Village Life, Westpoint, Concept Sports, Sons of Gwalia and CuDeco.

During the past decade the increase in class actions has coincided with an increase of privately held shares.

At present over half the Australian adult population owns shares whether through investments in managed funds and superannuation or privately [ASX Share Ownership Study 2004]. This increased shareholding has led to a heightened awareness on the part of shareholders in processes and mechanisms that will ensure the security of their investments and that will allow them to take appropriate action to recover losses when suffered.

A class action allows shareholders to combine their claims into one action and share the costs of that action.

Litigation funding of class actions allows shareholders to pursue claims that would not have been financially viable to pursue individually.

In class action litigation funding arrangements, the litigation funder contracts with each group member. The litigation funder pays the costs of the litigation and assumes the risk of paying the defendant's costs if the case fails. If the case succeeds, the litigation funding company is paid a share of the litigant's damages as agreed with the group member.

Shareholder class actions are often commenced shortly after ASIC has commenced an investigation or a civil prosecution against a corporation and its directors and officers.

Shareholder class actions can be more threatening to the financial health and viability of corporations than prosecution by ASIC. This is because shareholder class actions can result in a pay out by the corporation of many millions of dollars, which will have a bigger impact on the bottom line of a company than the fines and penalties that can be imposed by ASIC.

In addition to the availability of litigation funding, the rise of shareholder class actions has been aided by the legislative framework that exists in Australia and the increasing willingness of the Courts to test the boundaries of shareholders' rights.

Legislative Framework

Trade Practices Act, Corporations Act, ASIC Act

Misleading or deceptive conduct or statements by a company or its officers are often the cornerstone of shareholder class actions. The *Trade Practices Act 1974* (sections 52 and 53), the *Corporations Act* (section 1041H) and the *Australian and Securities Investments Commission Act* (section 12DA) all prohibit conduct or statements that mislead or deceive or are likely to mislead and deceive.

The Astor Goldsbrough class action

In 2000 a group of owners of apartments in the Goldsbrough Mort building at Darling Harbour who invested in a failed hotel scheme via a prospectus, commenced class action proceedings. The group members alleged that the promoters of the prospectus and the consultancy arm of a large accounting firm breached sections 51A and 52 of the *Trade Practices Act* and the then equivalent to section 1041H *Corporations Act*.

The Federal Court found that the representative applicant had been misled and deceived and ordered damages to be paid to her. This decision facilitated the settlement of the claims of the remaining 90 group members' claims, after a further trial on reliance and damages in relation to each group member [*Reiffel v ACN 075 839 226 Ltd* [2003] FCA 194].

The *Corporations Act* (section 728) also prohibits misleading statements or the omission of relevant information in disclosure and public offer documents. Section 670A of the *Corporations Act* also provides that a person must not issue a take over document if there is a misleading or deceptive statement in that document.

GIO class action

In 1999 a class action was commenced against GIO Australia Holdings Ltd, its directors and an independent valuer, which alleged that GIO had provided misleading information to its shareholders in a Part B document required by the *Corporations Act* during the hostile takeover by AMP. The Federal Court approved a settlement in 2003 of \$112 million [See *King v AG Australia Holdings Ltd (formerly GIO Australia Holdings Ltd)* [2003] FCA 1420]. Up to 68,000 shareholders were at one stage group members. There were 23,000 group member shareholders in the action at the time of settlement.

ASX Listing Rules

The ASX listing rules (listing rule 3.1) prescribe a continuous disclosure regime for companies. In particular, a listed entity must immediately notify the ASX of any information which a reasonable person would expect to have a material effect on the price or value of the securities of that entity.

Jubilee Mines Case

In an Australian first, on 6 September 2006, the Supreme Court of Western Australia ordered damages to be paid to a shareholder for a company's breach of the ASX listing rules on continuous disclosure, and the then section 1001 of the *Corporations Law*.

The shareholder, Mr Kim Riley, alleged that Jubilee Mines NL failed to disclose to the market in 1994 and 1995, the results of inadvertent drilling by WMC on a Jubilee tenement. The results disclosed a major nickel discovery which caused Jubilee's share price to jump when the discovery was eventually announced to the market in 1996. By that time Mr Riley had sold his shares in Jubilee for substantially less than he would have received in 1996. The Court found that the nickel discovery was information that would have had a material effect on the price or value of Jubilee shares and ought to have been disclosed [*Kim Riley in his capacity as trustee of the KER Trust v Jubilee Mines NL* [2006] WASC 199].

Whilst other Jubilee shareholders are now statute barred from bringing claims similar to that of Mr

Riley's, continuous disclosure cases are becoming a fertile ground for shareholder class actions.

The Aristocrat Leisure class action

One such class action involving continuous disclosure is the Aristocrat Leisure class action. This ongoing class action which is being funded by a litigation funding company, was commenced by shareholders in 2003 after Aristocrat announced a profit downgrade which resulted in a fall in its total market capitalisation of \$1.5 billion.

Shareholders allege that Aristocrat misled and deceived them and breached the ASX continuous disclosure requirements by providing misleading earnings and forecasts and by failing to make appropriate disclosure to the market between September 2002 and May 2003.

A Litigation Explosion? - Australian v US class actions

For reasons explained earlier, the incidence of shareholder litigation class actions will continue to rise in Australia.

In Australia it is probably easier to commence a class action than in the US, where it is required that class actions be certified by the Court after commencement, to continue as class actions. Australia does not have such a requirement, and it is up to defendants to challenge the validity of a class action as we have seen in *Fostif*.

However, the significant differences between the Australian and American judicial systems, in addition to the fact that litigation funding arrangements are likely to be regularised in the future [See "Litigation funding in Australia", Discussion Paper, Standing Committee of Attorneys-General, May 2006], suggest that there will not be an explosion of US style litigation in Australia. The differences include the following:

- Australian courts do not have the ability to award punitive damages to plaintiffs, whilst the United States legal system does. Consequently, plaintiff lawyers and litigation funders must identify, assess, value, cost an action and ensure that a sufficient number of group members have retained them to ensure the viability of the action, before commencing proceedings.
- In the United States, cases are heard by juries. In Australia, civil matters are usually heard by judges which is less likely to result in massive payouts.
- Lawyers in Australia are not able to charge their clients a percentage of their clients' damages as a fee, and must resort to 'no win no fee' fee arrangements. This contrasts strongly with the position in the United States where plaintiff lawyers are entitled to charge a percentage of the damages received by their clients. The consequence of this is the increase of litigation funding arrangements for class actions in Australia now allowed by reason of the decision in *Fostif*.
- In the United States, adverse costs orders are not made against unsuccessful litigants as they are in Australia. In the United States each party normally pays its own costs. In Australia, before commencing a class action, legislation and an assessment of the commercial viability of the class action, requires lawyers and litigation funders to be satisfied that the prospects of success of an action are not just reasonable, as required by legislation, but strong. In other words, speculative class actions will not be undertaken in Australia.
- In Australia, each individual shareholder who has suffered loss as a result of a misleading statement by the company, must prove that he or she relied on that statement. In the United States, it is presumed that the shareholders all relied on the misleading statement made by the company. This is known as the "fraud on the market" theory and is yet to be tested in Australia.

Implications for Australian Corporations

Any listed entity may be faced with a shareholder class action. For this reason, directors and officers of corporations should apply the principles of corporate governance with ever increasing vigilance.

This includes ensuring that:

- There is a proper corporate governance framework in place.
- There is adequate auditing to ensure compliance with the corporate governance

- framework.
- ASX is notified immediately upon receipt of any information that could be expected to have a material effect on the price or value of the securities of that entity.
 - No false, misleading or deceptive statements are made in prospectuses, public offer documents or other documents that are likely to induce shareholders to purchase shares in that entity.
 - Appropriate indemnities are in place including:
 - policies that respond to claims by shareholders of the company and class actions (known as side C cover); and
 - additional insurance for any high risk activity - eg merger & acquisition, issuing of a prospectus (such as a capital raising).

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