
SHAREHOLDER CLASS ACTIONS IN AUSTRALIA

current state of play

1. OVERVIEW

This note provides institutional investors with an overview of how class action litigation (particularly on behalf of shareholders) is conducted in Australia including, where appropriate, identifying differences between Australian and US class actions.

1.1. Federal Court or Supreme Court

Class actions can be conducted in either the Federal Court of Australia or in the Supreme Courts of most Australian States and Territories (for convenience, this note will only deal with Victoria and NSW).

The Federal Court is often regarded as the jurisdiction of choice in class action litigation, for a number of reasons, some practical, but many largely historic. In relation to shareholder class actions, the claims invariably rely on some or all of the Corporations Act 2001, the Trade Practices Act 1974, and the Australian Securities and Investments Commission Act 2001 all of which are Commonwealth legislation, providing the Federal Court with jurisdiction.

1.2. Group members

Class actions are more properly referred to as representative proceedings, as they are commenced in the name of one or more persons (the representative parties), who “represent” the interests of a defined group of persons (the group members) that are required to have the same, or a similar, interest in the litigation.

The Federal Court requires that there be 7 or more persons with claims against the “same person.” The Supreme Courts require only that there be “numerous” persons with such claims.

In each case, the proceeding is brought in the name of the representative party(s), with group members identified by a definition (for example, “persons who purchased securities in ABC Pty Ltd between 1 January 2005 and 31 December 2005.”) There is no requirement to disclose the identity of any group member other than the representative party(s).

1.3. Common questions of law & fact

In order for the proceeding to be sustainable as a class action, each of the Federal and Supreme Courts require that there be common questions of law and/or fact to determine.

In shareholder litigation, these issues will frequently include factual questions relating to what a company knew, or ought to have known and when, alongside legal questions such as whether the relevant information was material to the share price, or if a company’s treatment of financial data complied with the relevant Accounting Standards.

This requirement for common questions reflects the primary purpose of class actions, which is to assist in the effective and efficient administration of justice. There is no requirement to establish that group members were all affected by the one transaction, nor that they necessarily have claims against all defendants.

1.4. Open or closed class

Traditionally, class actions in Australia were commenced on an “opt-out” basis, namely that all persons fitting the definition of a group member were bound by the decision of the Court, unless they expressly opted-out of the proceeding by filing a notice with the court by a specified date.

More recently, there has been a trend towards the commencement of representative proceedings on behalf of a limited (closed) class of group members. This has coincided with the emergence of commercial litigation funders (CLFs) in the Australian legal market. In practice a closed class procedure is identical to an opt-out (for example, using the same provisions of the Federal Court Act), except that the definition of a group member is confined to those persons who “signed a litigation funding agreement with CLF xyz Limited on or before the date of commencement.” This will be discussed further in section 4 below.

1.5. Adverse costs

In all Australian litigation, there is a general principle that the unsuccessful party will be ordered to pay the successful party’s costs (an adverse costs order).

This is designed to discourage spurious litigation and recompense, to a degree, the defendant whose conduct was ultimately vindicated. The existence of adverse costs orders is one of the central reasons why it is unlikely that a “US-style” approach to civil litigation will ever emerge in Australia. In the US, the circumstances in which an adverse costs order might be made in a class action are far more limited than in Australia. In Australia, adverse costs orders in commercial litigation are the default position while in the US they represent the exception rather than the rule.

In the context of a class action, it is also important to note that an adverse costs order will only be made against the representative party, not group members to a proceeding. The Federal Court Act states this expressly.

2. HOW CLASS ACTIONS RUN

2.1. No certification process

In the US, there is a preliminary process where the lawyers commencing a class action apply for “certification.” In essence, this is an order of the Court that the claim has been properly constituted and is one that is appropriate to be run as a class action.

There is no equivalent in Australia, and instead the defendants will routinely bring interlocutory applications to challenge the ‘structure’ of the class action, in particular to attack whether the pleadings meet the requirements of the court rules. These applications will usually result in the statement of claim being amended and the progress of the claim delayed. There have been occasions where proceedings have been stopped altogether by the court at this stage. This tends only to occur when the court is satisfied that:

- (a) the claim is incapable of being articulated by the party bringing the claim; or
- (b) the claim cannot succeed even taking the claimant’s case at its highest.

2.2. Preliminary trial of common issues

As outlined above, while there must be a common issue to determine, there is no requirement that all group members have the “same” claim against all the defendants.

Accordingly, the practice in class action litigation has been for the court to first conduct a trial of the common issues of fact and law relevant to all group members, in conjunction with the determination of the individual elements of the representative party’s claim in full.

If this first trial is successful but the class action remains unresolved, the court will establish a process to enable the claims of individual group members to be determined. In shareholder litigation no claim has reached this point. All claims have resolved before judgment has been delivered in the trial of common issues. So far, in these resolved claims the requirement of proof by individual group member shareholders has been relatively undemanding. In other types of class actions the court has established mechanisms to enable group members to separately prove each of the individual elements of their claim.

3. ROLE OF LAWYERS

3.1. Fee charging

In Australia, lawyers are not permitted to charge “contingency fees” (fees that are calculated as a percentage of or otherwise with reference to the damages). Instead lawyers are only entitled to charge for the work that is performed.

In some cases, a lawyer will agree to conduct a case on a conditional fee basis, which means that all or some of the professional fees and disbursements are only payable in the event of a successful outcome.

In Victoria, lawyers are permitted to charge an “uplift” or success fee of up to 25% of the actual deferred legal costs as compensation for the risk involved in accepting a conditional fee retainer.

Given the complex and costly nature of class actions, particularly commercial class actions, lawyers are not usually prepared to conduct them on a wholly conditional basis. This has played a role in the rise of litigation funding in connection with such class actions.

4. ROLE OF LITIGATION FUNDERS

4.1. Central features

Litigation funding was upheld as a practice by the High Court of Australia in the case of *Campbells Cash and Carry Pty Ltd v Fostif Pty Ltd*. CLFs traditionally provide two central services in relation to any funded litigation: 1) they pay the legal costs involved in prosecuting a class action; and 2) they indemnify the representative party(s) and group members against any order for costs.

In exchange for these services, CLFs will usually require the reimbursement of their expenses plus a commission (usually 20 to 40% of damages) in the event that the claim is successful. They are not subject to the same prohibitions as lawyers in relation to the charging of contingency fees.

The ability to collect these contingency fees is not a result of the court rules, but rather a consequence of litigation funding agreements provided by CLFs to investors. This has led to the emergence of class actions that are confined to benefit those that become group members by signing a litigation funding agreement. This has been the response of CLFs to the perceived “free-rider” threat. The practice of confining a class to those who have executed a litigation funding agreement was endorsed by the Federal Court in *P Dawson Nominees Pty Ltd v Multiplex Ltd*.

5. SHAREHOLDER CLASS ACTIONS

5.1. Fraud on the Market

In the US, shareholder class actions proceed on the basis of the “fraud on the market” theory. This is based on a hypothesis that, in efficiently operating financial markets, the price of an exchange traded security will reflect the information that is generally available. Accordingly, where there is a fraud on the market, the security will trade at an artificially-inflated price. The amount of the inflation (determined by expert evidence) becomes the amount of the loss sustained by the purchaser in relation to each security purchased. This has a number of benefits, not least that it means that a shareholder can be said to have suffered a loss by the fact of their purchase, without any requirement to prove that they were “in fact” misled by the misleading information or the non-disclosure.

In Australia, the courts are yet to rule on whether this or a similar theory applies to the proof of causation in shareholder claims. However, there have now been several significant settlements in Australia in shareholder class actions. In each of those cases, the shareholder claimants have sought to argue a version of the “fraud on the market” theory. While the concept of “fraud on the market” is still a matter for judicial determination in Australia, our legislative framework appears to be flexible enough to accommodate the theory and the settlement of actions which have contended for it seems to be consistent with a degree of acceptance by practitioners within Australia.

5.2. Client Engagement

In the US, the first an institution may hear of a securities class action is on settlement. At this time, they will be asked to register in order to secure their entitlement.

In the Australian context, the advent of litigation funding means that institutional investors (in particular) are being asked to sign up to funding agreements prior to the commencement of the claim. This is because a CLF wants to secure enough eligible shareholdings, before making an investment, so that it can be satisfied that it will achieve a sufficient rate of return assuming the project is successful. Institutional investors are clearly crucial in this regard due to the relative size of their holdings.

5.3. Early Days

Shareholder class actions are still in their early days in Australia. A number of issues remain to be resolved. These include: how courts will eventually deal with the “fraud on the market” theory; how several class actions concerning the same dispute will be managed by the court; and how settlements of class actions will be accurately and efficiently disbursed. While it is reasonable to expect that US jurisprudence and practice will play a part in guiding Australian courts, it is also very likely that Australian courts will follow their own trajectory and shape a uniquely Australian outcome, reflecting our legal system and our culture.



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