The Australian Financial Review
Friday 5 March 2010 • www.afr.com

Class actions adrift in uncertain waters

A lack of clear directives for litigation is confusing and causing delays, write **Rachel Nickless** and **Hannah Low**.

Treasury will meet representatives from the class action industry next week to map out a new regulatory structure for litigation funding.

The meeting comes as lawyers, economists and litigation funders urge the government to tackle other areas of uncertainty in class actions, including how to quantify losses, amid fears unnecessary complexity is subjecting shareholders and the companies they sue to millions of dollars of additional costs.

Corporate Law Minister Chris Bowen has examined litigation funding regulations after October's Federal Court decision that found arrangements in the shareholder class action against Multiplex amounted to a managed investment scheme (MIS). The decision threw the industry into turmoil.

The Australian Securities and Investments Commission granted temporary exemptions from MIS registration to allow various class actions to continue. However, not all funding arrangements received exemptions. Some 20 class actions are thought to have been held up because of the Federal Court decision. For those actions it exempted, ASIC's "transitional relief" applies until June 30.

Ben Slade, principal at Maurice Blackburn, said the problem "requires the immediate attention of the minister". His firm had one matter waiting to be filed and another close to being filed, where there was a time limit issue, he said.

A spokesman for Mr Bowen said the government had an open mind on the appropriate regulation that should apply, would consider all options and consult all relevant stakeholders. The spokesman said the government would deal with the issue expeditiously "in order to give certainty to involved parties before ASIC's relief expires on June 30".

Action stations

Key shareholder class actions in court

Company	Law firm
Multiplex	Maurice Blackburn
AWB	Maurice Blackburn
Centro Properties Group	Maurice Blackburn/Slater & Gordon
OZ Minerals	Maurice Blackburn
Credit Corp Group	William Roberts
Village Life	Slater & Gordon

Shareholder class actions under investigation

Company	Law firm
Babcock & Brown Power	Slater & Gordon
GPT Group	Slater & Gordon
National Australia Bank	Maurice Blackburn

SOURCE: AFR

But the government has shown no interest to date in addressing growing uncertainty about what shareholders need to prove to establish a claim against a company in a class action. In recent years, there have been a string of corporate giants that have paid large settlements to groups of shareholders for alleged breaches of continuous disclosure laws or misleading and deceptive conduct.

The first was insurer GIO, which paid out $112 million to shareholders in 2003 after a four-year battle. In August 2008, Aristocrat settled a shareholder class action for $144.5 million. And last month, the Australian Wheat Board agreed to settle a class action for $39.5 million; the Federal Court will consider the settlement sum next month.

No shareholder class action has yet made it all the way to a final determination by an Australian court, which means parties have no guidance about how shareholders prove reliance and causation — the key building blocks to proving an action — or how damages should be quantified.

Middletons lawyer Mark Dobbie said the uncertainty disadvantaged companies and directors who were being sued. "When those sorts of amounts of money are at stake with no guidance from the bench about which way the hammer will fall, it's often a safer commercial bet to try to make a deal rather than run the risk of an unfavourable judgement," he said.

Mr Slade, who ran the class action on behalf of AWB shareholders, agreed the uncertainty was wasting resources and the correct measure of loss was "a science that's taking on a life of its own". But, he argued, it was

Parties have no guidance about how shareholders prove reliance and causation.

shareholders rather than corporate defendants who suffered. "These companies fight and fight and it goes for years and it costs everyone a huge amount of money, even though the companies are confronted by obvious wrongdoing . They use the uncertainty to extract a settlement that would not otherwise be possible," he said.

There are three models available to work out the amount of loss suffered in cases and plaintiffs typically use all three because they do not know which a court will prefer.

There is the relatively simple approach of "what's left in the hand", which calculates the difference between the purchase price and the market price (if shares are still held) or the sale price but it does not take into account other factors that may have affected the share price during the alleged period of misconduct.

Another option is attempting to determine how information that wasn't disclosed, but should have been, would have affected the discounted cash flow valuation of the company if it had been disclosed at the appropriate time.

The approach preferred in the US, which has a longer history than Australia of shareholder class actions, is the "event study". This takes the actual share price drop that occurred when the information was revealed and works backwards to determine the amount by which the market value at the time of acquisition differed from the "true value".

NERA Economic Consulting director Greg Houston, who has acted as an economics consultant or expert witness for either defendants or plaintiffs in most of Australia's class actions, said both sides wasted time and money because of uncertainty in the law about causation, reliance and damages. Parties now had little guidance on what a reasonable settlement amount might be, he said.

John Walker, executive director of litigation funder IMF, which funded the AWB class action among many others, said: "We think it would be good for the legislature to make clear in continuous disclosure and misleading and deceptive conduct cases, what proof of causation is necessary and the test for quantifying damages".

Mr Slade said Australia should embrace a similar concept to the "fraud on the market" theory used in the US, where it was accepted that the share price at any time reflected all the information in the market and there was no need for every single plaintiff in a class action to prove they relied on a breach of the law by a company in making an investment decision; reliance was assumed.

The government's corporate law adviser, the Corporations and Markets Advisory Committee, said in its report on the High Court decision in Sons of Gwalia, the doctrine of fraud on the market would be inappropriate to implement in the limited context of shareholder claims against insolvent companies. It said questions of causation, reliance and damages should remain matters for judicial determination and development.

Defence lawyers have said that the law required a direct reliance test, meaning that every individual shareholder would need to prove they acted upon a misrepresentation by purchasing shares.

Allens Arthur Robinson partner Ross Drinnan said the debate involved "a lot of really serious policy matters that need to be weighed . . . It is not something to rush into lightly because IMF and a few plaintiff lawyers say that legislation would answer all the problems".

Mr Bowen's spokesman said there were no plans to legislate with respect to quantifying damages in shareholder class actions.

Light regulatory touch may spur competition

COMMENT
James Eyers

The regulation of litigation funding has turned into the proverbial dog's breakfast.

The Standing Committee of Attorneys-General first examined the issue in 2005 before hurling it into the too-hard basket.

But since the Federal Court's ludicrous decision last October that the funding arrangements in the Multiplex class action amounted to a managed investment scheme, the need for government intervention has become starkly apparent.

On the top of the agenda at next week's meeting between class action players and Treasury will be determining whether the MIS decision should be allowed to stand. Plaintiff lawyers and funders will be calling for an amendment to the Corporations Act and Legal Profession Act to exclude litigation funding from the definition of a managed investment scheme.

They will argue that the Australian Securities and Investments Commission remains out of its depth in adjudicating on the raft of class action exemption requests it has been lumbered with since the MIS decision and that it was beyond the wildest contemplation of the legislature when it passed the MIS provisions that class action litigation would fall within its remit.

However, even if class action protagonists are successful in convincing Treasury on this, it remains far from clear what regulatory structure should be put in its place. The biggest funder, publicly listed IMF (Australia), wants strong prudential regulation through the Australian Financial Services (AFS) licensing regime — in part, because it already holds one.

But calls for AFS licences to be adopted more widely may run into opposition from some plaintiff lawyers, who want to see more competitive litigation funding pricing. They will argue that a strict licensing regime may put up a barrier to entry that will stifle competition in the funding industry.

This is because AFS licensing would be likely to require offshore funders — such as International Litigation Funding Partners, a special-purpose vehicle based in Singapore; and Comprehensive Legal Funding, which is based in Las Vegas — to submit to the local jurisdiction, something they would be unlikely to do given it would trigger tax liabilities.

In considering new regulation, it is important not to miss the wood for the trees. The two main risks for clients of litigation funders are the funder not paying the client's lawyer, or the funder refusing to pay an adverse cost order if the case is unsuccessful. Situations where funders have not paid are rare.

It would seem such risks may be ameliorated without moving to full-blown prudential regulation. The Standing Committee of Attorneys-General could, for example, call on the courts to change their practice rules to ensure that solicitor-client retainer agreements in funded actions contain minimum standards, such as preventing lawyers from seeking unpaid costs from the client directly, and requiring funders to pay security for potential adverse costs orders into a trust account for that purpose.

Such a regime would protect clients from a funder reneging on its obligations, while encouraging more competition, which also benefits funded litigants.