SMART MONEY

MUM AND DAD TAKE TO CLASS ACTION

Litigation is on the rise among retail investors, although it is not without its disadvantages, writes **Alex Boxsell**.

HOW TO JOIN IN

1. Look out for references to prospective class actions in the media or on the websites of litigation funders and law firms.
2. Decide whether you want to join the action, pursue your own litigation or do nothing at all.
3. You can only join a class action if you suffered a loss within a specified period. Check that you bought shares in the relevant period.
4. Some class actions remain open but funded ones are nearly always closed. Be careful to check the closing date of a class, because after this date it will be too late to join.
5. Calculate your loss. There is no need to crystallise your loss by selling shares, but ask yourself whether the losses justify the hassle to join.
6. Contact the law firm and obtain a copy of the litigation funding agreement if a funder is involved. Get independent legal advice to check what risks and costs you face, and the prospects of success.
7. The majority of investors will pay nothing upfront if signing with reputable funders. Be wary of any requests from funders to pay registration or contribution fees – it may suggest a lack of institutional investor support. But if a law firm is running the matter alone, fees must be paid upfront.
8. Once you've joined a class, sign up for regular email updates to check the progress of the case.
9. It is common for investors to band together in victims' groups. Inquire if one already exists.
10. Be patient – if the matter doesn't settle, litigation can take years to resolve.
Alex Boxsell

When large companies are dragged down by economic decline, it is not only falling profit, a dearth of credit and job losses that keep executives and directors awake at night. The ever-present threat of litigation lurks for those who fear they have misled or failed to adequately inform the market of their company's financial health. Auditors and financial advisers are not immune either.

Though regulators such as the Australian Securities and Investments Commission (ASIC) and Australian Securities Exchange can prosecute these cases, they have taken a back seat in most cases to the plaintiff law firms and litigation funders that favour the collective might of institutional and retail – or "mum and dad" – investors to call errant companies and advisers to account. Investor class actions have become big business in Australia, not only for the aggressors but the top-tier law firms enlisted to protect their corporate clients. A class action against GIO settled for $112 million in 2003 was bettered by the Aristocrat Leisure settlement in August 2008 for $144.5 million.

Similar actions are under way against Multiplex, Centro Properties, AWB and Opes Prime, while others are being considered against ABC Learning Centres, OZ Minerals and Allco Finance.

More and more large institutional investors are being lured by the chance of high returns and minimal risk of funded class actions in recent years, along with swathes of aggrieved mums and dads.

But for the retail investor, is a successful class action the windfall it is made out to be?

More money can be made by shareholders with sufficiently large claims who have the stomach for an individual law suit, assuming they win. But if they fail, investors risk picking up the hefty bill for the top lawyers and barristers their target is certain to hire, not to mention their own legal costs.

This is why the greatest drawcard a class action has to offer is the lack of risk. The vast majority of investor class members will pay nothing up front and nothing if they lose.

Under Australia's class action regime, only the lead plaintiff can suffer an adverse costs order. And if there is a funder involved, it will often shoulder this burden as well.

Such generosity does not come cheap. Funders typically take a commission of between 20 and 30 per cent, rising to as much as 40 per cent once the hard slog of a trial begins.

The major plaintiff firms in the market include Maurice Blackburn Lawyers and Slater & Gordon. Ben Slade, principal at Maurice Blackburn, says class actions give investors "access to a world-class justice system without any risk and without having any upfront costs at all".

Slater principal James Higgins says investors can benefit both from their successful actions and the positive impact major litigation has on standards of corporate governance; important because many investors keep diverse portfolios. Slater's class action approval process for shareholder class actions includes the criteria of institutional support and "a positive impact on corporate governance", Higgins says.

The executive director of litigation funder IMF (Australia), John Walker, says investors should realise they have two assets: their shares and their cause of action. Only the latter may have any real value when things go awry.

Defendant lawyers agree class actions help smaller investors, who might otherwise baulk at the cost of running their own cases, to access the justice system.

Mallesons Stephen Jaques partner Kate Mills says even an individual claim for as much as $500,000 could be uneconomic considering the potential legal and expert witness costs involved in

Continued next page

SMART MONEY

GROUP POWER SALVAGES STRATEGIC GAMBLE

Sydney share trader David McGowen's wife had always warned him that dabbling in the sharemarket was "educated gambling". But when he bought into gaming machine maker Aristocrat Leisure in 2001, it ended up more of a gamble than he could have known.

Aristocrat was sued following claims it had inflated profit announcements in 2001 and 2002, when sales of gaming machines worth $18 million were recorded before the money was received.

The resulting shareholder class action – a mix of big institutional and retail investors – alleged Aristocrat failed to disclose the reality of its accounts until 2003 when a downgrade in profit savaged the share price.

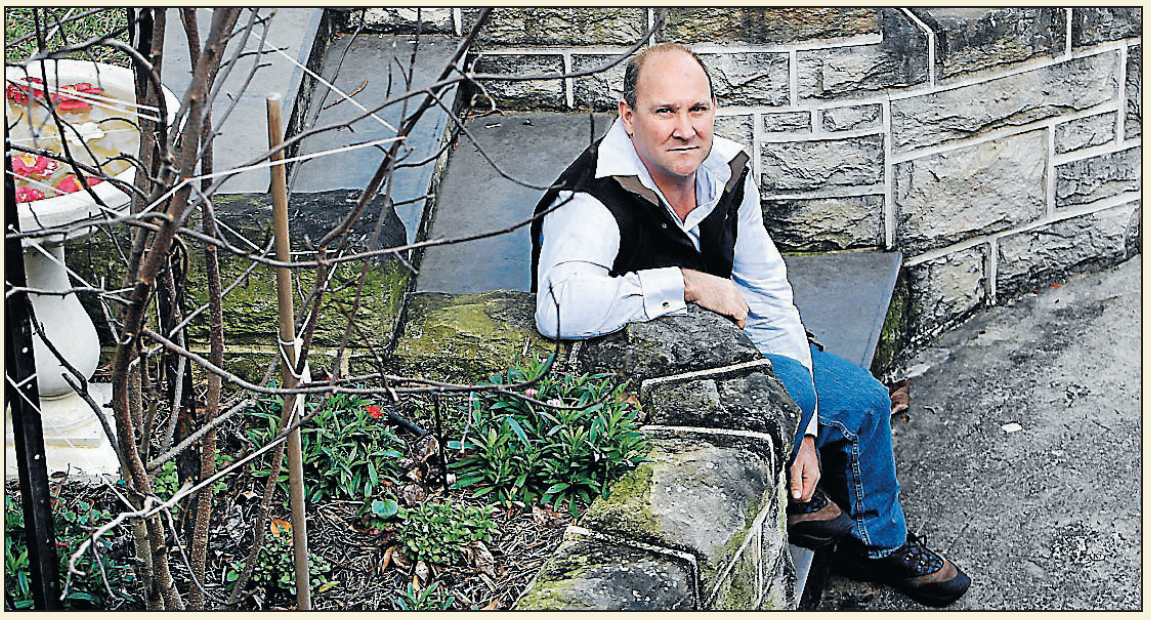
In August, the case became Australia's biggest shareholder class action settlement at $144.5 million after five years of litigation. McGowen, one of the first investors to get the class action rolling, lost about $25,000 on the stock.

"It was brought to my attention by my broker . . . And it all blew up from there when it became public in the media."

After running a company, McGowen now spends three-quarters of his time trading, though he has moved on from shares to options and foreign exchange. He bought into Aristocrat in 2001 when he thought the stock had bottomed out after being oversold.

"And then when it bottomed out again, the first thing you do is you double down. Take another bite at it," he says.

"As my wife says, it's educated gambling. You're stacking as many odds in your favour as you can. You don't win all of them and you never will. But you try to win more than you lose."



David McGowen: 'People have short memories'. Photo Rob Homer

You're stacking as many odds in your favour as you can. You don't win all of them and you never will.

McGowen had no previous experience in class actions but became interested after his broker suggested they seek legal advice. As one of the early movers, he paid about $300 to register the action. It was financed eventually by litigation funder IMF Australia and run by law firm Maurice Blackburn. But when the action reached the court he was not holding out for much of a return.

"The reality is I had written the loss off," he says.

"You make a decision, it didn't work, and you move on. So to me it was just a windfall."

After the case settled, McGowen got back about 90 per cent of his losses, with 70 per cent in the bank after IMF's commission and legal fees. But he doesn't begrudge the lawyers and funders their cut of the winnings. "You have got to understand they are taking a chance funding it.

"They would have spent several million dollars on all the work that they have to do," he says.

McGowen recommends other investors consider class actions if a wrong has been committed as "CEOs and companies need to be held accountable," he says.

"There shouldn't ever be an ounce of negligence."

But though class actions might initially improve corporate governance, he says executives and directors fail to learn from their mistakes.

"In trading and in financial institutions, people have very, very short memories."

Alex Boxsell

Mums and dads take to class action

From previous page

litigation. "For the majority of individual investors, who haven't got a lot of money or legal nous, it's a very expensive proposition to run without the advantage of a class," she says.

Blake Dawson's class action defence partner, John Emmerig, says plaintiff lawyers and funders tend to rely heavily on the strategy of running class actions as "attention grabbers". They seek to use the "multiplier effect", a procedure unique to class action litigation, to attempt to pressure defendant companies to settle claims. In this respect, it can be far more effective for shareholders to hunt in a pack.

"If I have a single shareholder with a $10,000 claim, that is not going to get any attention," Emmerig says.

"But if there are 10,000 shareholders with a $10,000 claim, that $100 million claim would quickly get the attention of the chief executive."

However, there are potential disadvantages for investors too. Shareholder class actions are far more attractive to funders and lawyers if the large institutions are on board, the interests of which some argue will take precedence over retail investors.

The trade-off for mums and dads reluctant to go it alone in litigation is that they lose the ability to be a decision-maker. Freehills senior associate Jason Betts says class members have traditionally had little control over strategic or forensic decisions made by the lead plaintiff.

"A settlement could occur in circumstances where not every class member has been involved in negotiating the settlement. Maybe they don't even approve of the settlement," Betts says.

IMF's Walker acknowledges a failed class action is a waste of everyone's time and money, one of the reasons why targets are selected carefully. Large legal claims represent a distraction for executives which might hinder their ability to navigate their company out of trouble.

Blake's Emmerig says studies in the United States show class actions cause a 10 per cent reduction on share price during the life of the claim.

"If you still hold shares in the target company, the irony is that by bringing the class action you may be hurting your own financial interests," he says.

But Walker says stock prices usually bounce back once a class action is resolved as "it's a one-off payment that addresses the past and the market just looks to the future when assessing the value".

The Part IVA class action regime began in Australia in 1992 when new Federal Court laws were introduced. Through the 1990s, class actions were used by plaintiff firms seeking compensation on product liability cases, characterised by asbestos, breast implant and pace-maker claims.

While these still exist – Slater & Gordon is pursuing pharmaceutical giant Merck over its anti-arthritis drug Vioxx that some claim is linked to heart attacks – they have largely been usurped by shareholder claims.

The trade-off for mums and dads reluctant to go it alone in litigation is they lose the ability to make decisions.

Class actions are also being run where investors lose money due to alleged bad financial advice.

ASIC is suing former executives and directors of property financier Westpoint, financial advisers and auditor KPMG on behalf of 4300 investors after the company collapsed in 2006. ASIC has said the claims would benefit 85 per cent of shareholders.

A prospective class action against financial advisers Storm Financial, and ASIC's investigation of Storm, led to "an accelerated resolution process" being entered into between plaintiff lawyers Slater & Gordon and Commonwealth Bank of Australia last month over its involvement with Storm.

Since 1992 there have been more than 200 Part IVA proceedings, but Monash University class action expert Vince Morabito says, "contrary to public opinion, there does not appear to have been an appreciable increase in the number of class actions, due to litigation funders, in the last couple of years".

Most are run in the Federal Court, but they can also appear in state supreme courts. They have historically been "opt out" classes under the Part IVA system, which means investors who fit the criteria of the class do not have to do anything to be involved.

GIO and Aristocrat were opt-out cases.

But "opt-in" classes are growing in popularity because they give more economic certainty to funders and the large institutional investors they are trying to attract to take part in litigation.

These classes remain "open" until a specified deadline, usually a year after a matter has been commenced, at which point they will be "closed". Once a class is closed it will be too late for additional investors to join.

"The economics of litigation funding has created this need to have a closed class, because institutions, acting off self-interest, won't sign up if they don't need to," Slater's Higgins says.

"Shareholders must come forward. They can't continue to think that the system still is as it was; that they can just file their forms when they hear there is money in the offing.

"With a closed class, institutions now know they should sign up before it starts. That [message] has not got through to retail investors yet."

Classes can be closed by the group or by the requirement to sign a litigation funding agreement.

They might also be closed by a fee or retainer agreement signed with a law firm.

Legal eagles

Status of major class actions

Class actions in court

Target companies	Law firm	Litigation funder
• **Airline** (cargo cartel)	Maurice Blackburn	IMF
• **Amcor/Visy** (cartel)	Maurice Blackburn	
• **AWB**	Maurice Blackburn	IMF
• **Centro Properties Group/Retail Trust**	Maurice Blackburn/ Slater & Gordon	IMF/Comprehensive Legal Funding
• **Challenger**	Maurice Blackburn	IMF
• **Credit Corp Group**	William Roberts	IMF
• **Merck** (Vioxx)	Slater & Gordon	
• **Multiplex**	Maurice Blackburn	International Litigation Funding Partners
• **Opes Prime**	Slater & Gordon	IMF
• **Qantas** (fuel surcharge)	Slater & Gordon	Litigation Lending Services
• **Sons of Gwalia**	n/a	IMF
• **Village Life**	Slater & Gordon	IMF
• **Westpoint**	Slater & Gordon	IMF

Class actions being considered

• **ABC Learning**	Maurice Blackburn	IMF
• **Allco Finance**	Maurice Blackburn	IMF
• **Fincorp**	Slater & Gordon	
• **GPT**	Slater & Gordon	
• **ION**	Slater & Gordon	IMF
• **Octaviar** (formerly MFS)	Maurice Blackburn	IMF
• **OZ Minerals**	Maurice Blackburn/ Slater & Gordon	IMF/Litigation Lending Services
• **NAB** (CDO obligations)	Maurice Blackburn	International Litigation Funding Partners
• **Storm Financial**	Slater & Gordon	

Class actions settled recently

• **Aristocrat Leisure**	Maurice Blackburn	IMF
• **Downer EDI**	Slater & Gordon	IMF

SOURCE: AFR RESEARC