



# Class Actions

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This paper affects insurers who issue product liability policies, public liability policies, professional indemnity policies particularly those of financial advisers and accountants / auditors, directors and officers.

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# Table of Contents

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<b>1.</b>	<b>What are class actions?</b>	<b>3</b>
<b>2.</b>	<b>Class actions – a short history</b>	<b>3</b>
2.1	Introduction	3
2.2	Product liability and compensation	4
2.3	Evolution of financial loss claims and the corporate governance	4
2.4	Usual legal basis of financial loss claims against corporations	5
2.5	Usual legal basis for claims against directors generally	6
2.6	Trends	7
<b>3.</b>	<b>The Class action industry – big business</b>	<b>8</b>
3.1	Claimant law firms	8
3.2	Litigation funding	9
3.3	Court Procedures– an outline	9
<b>4.</b>	<b>Some procedural issues</b>	<b>11</b>
4.1	Introduction	11
4.2	Defining the class and identification of class members: section 33H	11
4.3	Limiting class sizes – Claimant’s lawyers and litigation lenders hitting back: section 33H and section 33J	12
4.4	Common issues of fact (and judicial support of litigation funding): section 33C	14
4.5	Claim against each respondent	15
4.6	Security for costs	15
4.7	Disclosure of insurance policies	16
<b>5.</b>	<b>Conclusions</b>	<b>17</b>
5.1	General Observations	17
5.2	Implications for insurers	17

## Class Actions

This paper affects insurers who issue product liability policies, public liability policies, professional indemnity policies particularly those of financial advisers and accountants/auditors, directors and officers.

## Class Actions

### 1. What are class actions?

Class actions are representative proceedings brought by one person on behalf of a group of people.

The **aim** of class actions is to resolve common issues and factual disputes amongst that group.

The main **benefit** of class actions is in enabling a dispute involving potentially large numbers of people to be resolved by way of a single case.

The **justification** or philosophy of class actions is in enabling a dispute to be commenced in the first place in circumstances where:

- individual claimants entitlements are relatively low; and/or
- due to the impecuniosity of claimants.

Without the benefit of access to the class action system these claimants would never see the inside of a court room. This is known as the access to justice philosophy.

### 2. Class actions – a short history

#### 2.1 Introduction

The first Australian class action regime was enacted and took effect on 5 March 1992 Part IV of the *Federal Court Act*. The legislation was created in response to a Law Reform Commission report completed in 1998.

Prior to this, rudimentary procedures had existed in the court rules of most states and territories of Australia relating to “representative” actions. However, those provisions were not afforded a liberal interpretation by the courts and with an inadequacy of accompanying procedures the rules fell into disuse.

The Federal Court regime provides the most complete set of rules and is where most class actions are brought.

Only Victoria has introduced a class action scheme which is essentially identical to the Federal Court scheme under Part 4A of the *Supreme Court Act 1986* (Vic). In other States and Territories, there are representative procedures available but they are not, strictly speaking, “class action” schemes.

After initial low levels of interest, class actions have developed momentum in Australia in both the variety of actions and their frequency.

## 2.2 Product liability and compensation

Early class actions centred around product liability cases. Some examples of these cases include:

- **Pharmaceutical and medical devices**
  - Copper 7 litigation - GD Searle & Co and uterine contraceptive devices (IUD's)
  - Fen-Phen litigation - Servier Laboratories and side effects to Ponderax and Adifax consumption
  - Breast implant litigation - Baxter Group and Dow Corning
  - St Jude Pacemaker litigation
- **Mining and industry**
  - Automotive - Mac Trucks
  - Mining – Ok Tedi mine copper waste into the Ok Tedi and Fly River systems
  - Longford Gas Plant class action
  - Benlate Fungicide – the worldwide agricultural product
- **Food and water**
  - Sydney Water – financial loss due to water contamination
  - World Hot Bread Bakery – salmonella poisoning
  - Melbourne Aquarium - Legionnaires' Disease

The early class action cases, especially the IUD and breast implant cases, obtained their impetus from international class actions. As continues to be the case, Australian law firms join with international law firms in the United Kingdom, Canada and United States to pursue claims.

## 2.3 Evolution of financial loss claims and the corporate governance

In addition to the early access to justice philosophy, class actions have developed a new regulatory type role as these actions have themselves moved into corporate governance areas of financial loss such as:

- Shareholder actions for non disclosure or misleading disclosure in relation to financial position, releases of information to the ASX, takeovers and prospectuses;
- Damages for cartel conduct – price fixing and market rigging; and
- Recovery of monies illegally received and withheld or for illegal or negligent conduct otherwise.

Some examples of financial loss cases:

- **Aristocrat** - Federal Court proceedings, arising from a profit downgrade in 2003. This was the largest shareholder class actions in Australia to be brought to trial (and now settled). The settlement in August 2008 for \$144.5million is the largest settlement in Australian history.
- **AWB** - Commenced by shareholders alleging breaches by AWB of the Australian Stock Exchange's continuous disclosure rules.
- **Ord Minnett** - Proceedings brought by more than 100 investors, arising from trading in derivatives and equity financial products.
- **GIO** - Shareholder class action being brought by former GIO shareholders against GIO's directors, its advisors and insurers following the takeover by AMP a \$97million settlement in November 2003 involving 22,051 shareholders.
- **Telstra** - A class action which alleged that Telstra had failed to disclose a number of material financial matters to the market.
- **Tax schemes** - Federal Court class action brought by group of retail investors against Cardinal Financial Securities and others, arising from a tax-driven technology scheme.
- **Myer Centre** - Claim by shareholders / noteholders of Interchase Corporation in class action proceedings in the Federal Court against officers of the company in relation to a valuation which appeared in the prospectus for the failed Myer Centre in Brisbane.
- **Corrugated packaging cartel** - Claim against Amcor for \$300 million alleging cartel conduct with Visy in the corrugated packaging industry. The Federal Court proceedings were commenced by several customers and arise out of investigations by the ACCC.

## 2.4 Usual legal basis of financial loss claims against corporations

Many of the above actions are founded against companies in reliance upon the Corporations Act. Some common provision relied upon include:

- In relation to disclosure documents protection:
  - S 710(1) – compulsory disclosures in a prospectus
  - S 728(1) – disclosure documents must not be misleading
  - S 728 (2) – must have reasonable grounds for making a statement about the future
  - S 729 (1) – list of people from whom a shareholder may recover, including “6. a person who contravenes, or is involved in the contravention of, ss 728(1)”
- In relation to continuous disclosure:

- S 674(2) – compulsory notification of information a reasonable person would expect, if it were available, to have a material effect on the price or value of the shares
- S 674(2A) – a person involved in the companies’ contravention contravenes this section
- In relation to misleading and deceptive conduct:
  - S 1041H – a person must not engage in misleading or deceptive conduct, or conduct that is likely to mislead or deceive, in relation to a financial product
  - S 769C – representations about future matters are misleading unless representor has reasonable grounds

## 2.5 Usual legal basis for claims against directors generally

- In an action for damages under the *Corporations Act* or *Trade Practices Act*, investors can claim damages against a person who directly engaged in the misconduct or against “*any person involved in the contravention*”: section 1041 of the *Corporations Act*, section 82 of the *Trade Practices Act*.
- It is commonly pleaded that the defendant company engaged in the contravening conduct is the principal offender, whilst individuals, such as directors, are alleged to have an “*accessorial liability*”.
- A “*person involved in a contravention*” is defined in section 79 of the *Corporations Act* and section 75B of the *Trade Practices Act* as a person who:
  - has aided, abetted, counselled or procured the contravention;
  - has induced, whether by threats or promises or otherwise, the contravention;
  - has been in any way, directly or indirectly, knowingly concerned in, or party to, the contravention; or
  - has conspired with other to effect the contravention.
- The *Corporations Act* also contains other breaches for which directors may be liable, and thereby be exposed to pecuniary penalty orders (section 1317G) and compensation orders (section 1317H):
  - failure to exercise and discharge duties with due care and diligence (section 180);
  - failure to exercise powers and discharge duties in good faith and for a proper purpose (sections 181 and 184(1));
  - improper use of position as a director or officer of corporation for personal advantage or to cause detriment to the corporation (sections 182 and 184(2)); or
  - improper use of information obtained in office for personal advantage or to cause detriment to the corporation (sections 183 and 184(3)).

- In addition, section 588G of the *Corporations Act*, creates a statutory duty upon directors to ensure the companies they control do not incur further debts after the companies are insolvent – prosecutions under this section will continue if directors unreasonably believe their company fortunes will improve.

## 2.6 Trends

Consistent with the regulatory role that class actions now play, and their ability to attack the business world at large, the number of class actions based on corporate governance complaints is becoming a feature. The current global crisis infected by huge financial losses to both private and institutional investors has seen a plethora of companies exposed to current class actions.

In addition the modern government regulatory “*watch dog*” bodies (such as the Australian Securities and Investments Commission (ASIC), Australian Prudential Regulatory Authority (APRA), Australian Competition and Consumer Commission (ACCC)) carry out royal commissions, inquiries and criminal investigations. These inquiries often lay the foundations for class action lawyers to bring their civil claims against defendant corporations and their directors.

There is even provision in the *ASIC Act 2001* for ASIC to bring recovery actions on behalf of investors: section 50 of the ASIC Act. In reliance on this power ASIC is currently bringing recovery proceedings on behalf of investors in the Westpoint case.

Governments are not immune from class actions. A class action is currently on foot against the Federal Government arising from alleged misfeasance in the use of certain powers: the Pan Pharmaceuticals case.

Finally, natural disasters, which appear to be ever on the increase, have become fertile ground for class actions especially against government. On Friday 13 February 2009 the largest class action in Victoria was commenced against electricity distribution company SP AusNet and the Victorian Government in relation to some of the recent Victorian bushfires (those fires which started when power lines fell during strong winds) for negligent management of power lines and infrastructure.

Descriptions of some of the current pieces of litigation on foot or currently being advertised involve the following:

- **Pan Pharmaceutical** - class action commenced in September 2008 by former shareholders against the Federal Government’s Therapeutic Goods Administration over its decision to order a recall of 16000 Pan-manufactured products for malfeasance in recalling the products and suspending Pan’s license;
- **Victorian Bushfires** - against electricity distribution company SP AusNet and the Victorian Government in relation to some of the recent Victorian fires which started when power lines fell during strong winds for alleged negligent management of power lines and infrastructure;
- **Air Cargo Class Action** – commenced in January 2007 against seven major airlines claiming losses as a result of price fixing on surcharges in international freight services;
- **Rubber Chemicals class action** – commenced in September 2007 against Bayer and Chemtura (formerly Uniroyal) for fixing the price of Rubber Chemicals;

- **Centro Class actions** – a number of separate actions brought in 2008 for inadequate continuous disclosure of financials position generally and in connection with purchase of certain securities;
- **Oz Minerals** – failure to properly disclose of financial position in connection with a merger between Oxiana and Zinifex; and
- **Downer – EDI** – failure to fully inform market of financial position.

### 3. The Class action industry – big business

The business of class actions is big business. As an industry it requires at least three key elements to thrive. These include:

- well structured and resourced specialist claimant law firms (**claimant law firms**);
- access to funding (**litigation funding**); and
- a litigation system conducive to the maintenance of class actions (**court procedures and case law**).

#### 3.1 Claimant law firms

There are two law firms that specialise in class actions – Maurice Blackburn and Slater & Gordon. Slater & Gordon is listed on the stock exchange.

These firms are highly organised and have a significant market presence. Their websites illustrate this.

The following are the current class actions of these two firms as listed on their respective websites:

##### **Maurice Blackburn**

- Air Cargo Class Action
- Amcor/Visy Class Action
- AM Corporation & Lifetrack Superannuation Fund Class Action
- AWB Class Action
- Centro Class Action
- Challenger Class Action
- Media World Class Action
- Multiplex Class Action
- Rubber Chemicals Class Action
- Tate Class Action

## Slater & Gordon

- AFD
- Cranbourne Gas Emission
- Centro Shareholder Actions
- Downer EDI
- Fincorp Investor Class Action
- Fuel Surcharges
- GPT Group Class Action
- ION
- Opes Prime
- Oz Minerals Group
- Storm Financial
- VIOXX

### 3.2 Litigation funding

Maintenance and champerty has been abolished in Australia.

The High Court has held there is no impediment to litigation funding although the terms of funding may give rise to implications involving the court. These include security for costs requirements, approval of terms of settlement, and in the case of liquidators and litigation funders, questions of costs are reviewed by the court.

Litigation funding is addressed as a separate topic but it is worth noting there are a number of private and public litigation funders in the Australian market. IMF Australia Ltd (**IMF**), a listed company, just reported a profit of AUD18.758 million for the six months up to 31 December 2008.

Indeed, virtually all of the matters currently being run by the two main plaintiff firms have litigation funding.

### 3.3 Court Procedures– an outline

In Australia, class actions are most adequately dealt with in Part IVA of the *Federal Court Act* which is headed “*Representative Proceedings*”.

In this paper we will not trawl through all the sections. We provide a complete copy of Part IVA as **Appendix 1**.

There are a number of important rules in the Federal Court.

Sections 33C and 33H are the most important and give rise to the most number of procedural issues.

Section 33C provides that class actions can be commenced by a representative applicant in circumstances where:

- seven or more people have claims;
- which arise out of the same, similar, or related circumstances; and
- give rise to a substantial common issue of fact or law.

Section 33H sets out the following requirements in the originating process:

- describe or otherwise identify the **group members** to whom the **proceeding** relates;
- specify the nature of the claims made on behalf of the **group members** and the relief claimed; and
- specify the questions of law or fact common to the claims of the **group members**.

Once the class is described, every person in that class is assumed to be part of the class unless they decide to “*opt-out*” of the action by filing a notice with the court in a specified form – see section 33J.

The representative applicant does not need the consent of the class members and does not even need to know who they are or where they live. (This in comparison to the US procedure which is “*opt-in*”.)

In many respects the Australian class action procedure is more “plaintiff friendly” than in the US. This is because in Australia:

- there is no certification requirement (i.e. a requirement to satisfy the court that the proceedings meet the requirements for a class action before it proceeds);
- the class members in Australia are required to opt out rather than opt in;
- there is no need to show that the common issues predominate over individual issues - it is enough that there be one common issue which is “real or of substance”; and
- the courts have the power to manage the litigation by splitting the class into sub-groups to deal with discrete issues. This gives the Australian courts a wide discretion to deal with a group of claims as a class action.

**Appendix 2** includes an article which appeared in NSW’s Sydney Morning Herald on Wednesday 11 March 2009 reporting on a guest speech by American law academic Professor Geoffrey Miller to the Federal Court of Australia which points out some of the procedural benefits of the Australian class action system compared to the US system.

On the other hand there are a number of key differences which suggest that class actions will continue to remain a mere fraction of that seen in the US.

In the USA:

- attorneys race to be first to file to control the class;

- attorneys fees, usually around 30% of the recoveries (subject to Court approval), is payable from the global recovery, without the need for contractual consent of the class members; and
- neither attorneys, nor the class members, are liable for adverse costs orders.

By contrast, in Australia:

- solicitors are ethically and legislatively prohibited from charging their clients a percentage of the recovery;
- funders, with contractual agreement of each client, charge a percentage of the recovery and pay all costs associated with the litigation; and
- parties are exposed to adverse costs and funders pay all adverse cost orders.

## 4. Some procedural issues

### 4.1 Introduction

Issues such as cost and delay and using procedure to create hurdles generally are relevant strategic considerations taken into account by competent defence lawyers on a case by case basis.

A respondent client and its lawyers must always challenge themselves on the merit of cost, delay and general mischief against more forensic questions such as:

- whether the challenge is ultimately likely to be detrimental to the respondent because the plaintiff may be allowed to re-plead with the benefit of judicial guidance; and
- whether the challenge is likely to beneficially improve the focus of the class action.

For example, restricting the class membership to a better defined class may benefit a respondent by providing certainty (and limitation) as to the quantum of damages.

Set out below are some of the procedural issues that confront claimant class action lawyers.

### 4.2 Defining the class and identification of class members: section 33H

In a class action, the representative of the class must not only properly plead the case alleged by it on its own behalf but also the case alleged on behalf of the members of the group.

In *Auskay International Manufacturing & Trade Pty Ltd v Qantas Airways Ltd* [2008] FCA 1458 is a cartel action. On 29 September 2008 the Court considered whether a class was defined too widely.

Section 33H(1)(a) of the *Federal Court of Australia Act 1976* (**FCA Act**) requires that the group members to whom the proceeding relates are to be clearly identified.

The Auskay class action included a wide definition of the class. The class members were:

*“... all those persons currently resident in Australia who during the period 1 January 2000 to 11 January 2007 ... paid more than twenty thousand Australian dollars (AUD\$20,000) for the carriage of goods to or from Australia by air and who are not related parties of the Respondents or any of them within the meaning of the Corporations Act.”*

The central allegation in the *Auskay* class action was that the airlines were members of a cartel which had agreed to and did fix a number of charges related to international airfreight into and out of Australia. It was alleged that the price of international airfreight had been increased by the imposition of agreed fuel, security and war-risk surcharges.

The airlines challenged Auskay’s claim on the basis that it failed to sufficiently plead a case against them. Insofar as the “definition of class” was concerned, the argument advanced on behalf of the airlines was that the definition of the class membership had insufficient precision which made it impossible for the airlines to plead a defence.

The court observed that the definition of the class membership was very wide and could include members who were located overseas and made payments in relation to airfreight travelling to or from Australia. Also, the class could include members who had directly and indirectly acquired services.

Furthermore, the court observed that there were two further subgroups of the class, being those who both paid and acquired services and those that simply paid for services.

In *Auskay*, the court held that the class had not been identified with sufficient precision and this caused an insurmountable difficulty when considering the inter-relationship between the widely defined class membership and the damage allegedly suffered.

The court considered that, by drawing such a wide class, a number of difficulties arose because:

- (a) Even if it were assumed that the airlines did agree to inflate prices, it did not follow that the airlines charged inflated prices on all occasions on which a class member sought to obtain services from an airline.
- (b) The class was not limited to when a member had paid inflated prices for services but rather covered all services, whether the price was inflated or not.

Auskay has been granted leave to replead its case.

The decision in *Auskay* is an important illustration of the pitfalls that can be encountered when attempts are made to define the class too widely.

#### **4.3 Limiting class sizes – Claimant’s lawyers and litigation lenders hitting back: section 33H and section 33J**

Perversely litigation lenders and claimants’ lawyers have come up with a way of overcoming the “*opt out*” burden of non paying class members by including in its description of a class of litigants those who have entered into a litigation funding agreement. This is colloquially known as the “*opt in*” trick (as opposed to the “*opt out*” test).

This practice was regarded as acceptable in the Federal Court. In the recent case of *Multiplex Funds Management Limited v P Dawson Nominees Pty Limited* [2007] FCAFC 200 was decided by the full Federal Court on 21 December 2007.

In that case the Court upheld the decision at first instance that to limit a class by description according to whether the claimants had a litigation funding agreement in place was not inconsistent with the section.

## **Background**

In the Multiplex shareholder class action proceeding, membership of the represented class is defined not by the retainer of a particular firm of solicitors, but instead with reference to whether group members had entered into a litigation funding agreement with the litigation funding firm, International Litigation Funding Partners, Inc., before litigation began (the ILF criterion).

Multiplex brought an application seeking orders that the proceedings be discontinued as representative proceedings under Part IVA of the FCA on the basis that the ILF criterion imposed an “opt in” obligation on members of the represented group. This was said by Multiplex to be inconsistent with the terms and policy of Part IVA. More specifically, Multiplex alleged that the ILF criterion was “inefficient” or “otherwise inappropriate” under section 33N of the FCA and that for either or both of these reasons it was in the interests of justice that the representative proceeding be discontinued.

At the time, therefore, of the Multiplex appeal judgment, inconsistent views had been reached by members of the judiciary in the Federal, Victorian and New South Wales jurisdictions as to the validity of defining a represented group with reference to the entry by group members into retainer and/or funding agreements.

## **The Multiplex appeal decision**

On 21 December 2007, the Full Court of the Federal Court dismissed Multiplex's appeal. The court held that membership of a represented group in Part IVA proceedings could be defined by reference to entry into a litigation funding agreement.

The Full Federal Court concluded as follows:

- (a) To discontinue proceedings under s33N, the court must find – having regard to all of the circumstances of the proceeding – that one of the grounds in that section (including inefficiency or inappropriateness) exists, and that by reason of that ground or grounds, it is in the interests of justice that the representative proceedings should be discontinued.
- (b) The court may look to the purpose served by continuing the proceeding as a representative proceeding. This includes consideration of the way in which the represented group is defined. The mere fact, however, that the group does not include every member of the class who may have claims against the respondent does not resolve the question.
- (c) On its terms, Part IVA does not preclude the definition of the represented group by reference to the entry by group members into a litigation funding agreement with a named funder. Part IVA expressly provides that a representative plaintiff may represent “some” of the group members.
- (d) Group members must be entitled under the litigation funding agreements to opt out of the proceeding. Provided this condition is met, it is not relevant to consider any practical disincentives to group members opting out contained in the litigation funding agreements. In this case, notwithstanding that practical disincentives existed, group members were entitled to opt out.

- (e) The court may examine the availability of other proceedings, but not other Part IVA proceedings (such as proceedings with a differently constituted represented group). Nonetheless, nothing in Part IVA mandates a detailed examination by the court of a comparator “*non-representative*” proceeding. The focus is on the efficiency and appropriateness of the claims in the existing representative proceeding. Justice Finkelstein had not undertaken this approach, but did not fall into appellable error.
- (f) The risk of a respondent facing multiple representative proceedings is inherent in Part IVA, which expressly allows for representative proceedings limited to “*some*” members of the class. This risk, of itself, is insufficient to produce a finding that the representative proceeding is inefficient or inappropriate. A different finding might be reached if there is evidence of other proceedings that may cause real inefficiency or inappropriateness. No such evidence existed here.

### **Comment**

The court will consider the way in which a represented group is defined when assessing whether a representative proceeding should be discontinued in the interests of justice because it is inefficient or otherwise inappropriate. The Multiplex appeal determined that in the federal jurisdiction a represented group under Part IVA may be defined by reference to the entry by group members into a litigation funding agreement with a named litigation funder.

It follows that the position taken by Justice Stone in *Aristocrat* is clearly in doubt: The Multiplex appeal decision would therefore appear to be inconsistent with current jurisprudence in Victoria (*Rod Investments*) and New South Wales (*Jameson*) on the legitimacy of limiting a class to those who have entered an agreement with a particular litigation funder. Multiplex may decide to seek special leave to appeal to the High Court to resolve the inconsistency.

These differing approaches demonstrate the current uncertainty concerning the limits of the role of litigation funders in proceedings, particularly representative or class action proceedings, to which they are not a party. The Full Federal Court in the Multiplex appeal commented that Part IVA was enacted before the advent of modern litigation funding. The text of the FCA therefore does not directly address the issue, and the use to which sources of legislative interpretation contemporary to the enactment of Part IVA can be put is limited.

The Full Federal Court appears to have indicated that it is the role of Parliament, not the courts, to regulate litigation funding. Regulation of the litigation funding industry is currently the subject of consideration by the Standing Committee of Attorneys-General and the Victorian Law Reform Commission, as part of its review of civil justice proceedings. A committee of the Council of Chief Justices of Australia and New Zealand is also considering whether consistent court rules should be made relating to litigation funding. It remains to be seen whether Parliament or the court seek to balance the conflicting access to justice issues differently following the various reviews underway.

#### **4.4 Common issues of fact (and judicial support of litigation funding): section 33C**

A series of procedural victories by investor class actions has continued with a NSW Court of Appeal judgment in favour of 51 people who lost money in the Westpoint collapse - *Jameson v Professional Investment Services Pty Ltd* [2009] NSWCA 28 on 25 February 2009.

The decision overturns a ruling in December 2007 that there was insufficient common interest among all 51 aggrieved clients of the financial adviser Professional Investment Services for the case to be tried as a class action.

In the initial ruling, Justice Peter Young said if a class action proceeded against Professional Investment Services for recommending the purchase of Westpoint promissory notes, it would be "*necessary to try the issue as to each claimant as to whether there was a misleading statement made to him or her and, if so, whether reliance has been established*".

The Chief Justice, Jim Spigelman, the President of the Court of Appeal, Justice James Allsop, and Justice David Ipp said this finding failed to take into account that all plaintiffs were claiming that a product disclosure statement should have been issued. Justice Spigelman:

*"In order to prove causation and damages, each member of the group may have to give evidence about the effects upon him or her of whatever it is determined to have been the required contents of the product disclosure statement.*

*"However, the scope and significance of the matters in issue about the content of the statement are such that, should [the investors] succeed in this respect, it appears to be unlikely that there will be much dispute on issues such as reliance and causation."*

There were also "*substantial common issues of fact*" in relation to allegations that investors were told Westpoint would provide a guarantee, the appeal judges said.

Another important factor was that no litigation funder was likely to back individual suits by the 51 plaintiffs, impeding their access to justice.

The amounts invested ranged from \$50,000 to \$550,000, with 38 investors claiming \$130,000 or less. "*On these figures the majority of the proposed group members would, in my opinion, find great difficulty in justifying the risks of separate litigation*" Justice Spigelman said.

#### **4.5 Claim against each respondent**

It is currently unclear whether each class member must have a claim against each named respondent. While Auskay did not resolve the issue, it appears to support the view that this connection is required.

The issue of class actions and pleading a case against each respondent will shortly enter new levels of complexity because of the effect of proportionate liability legislation.

#### **4.6 Security for costs**

Courts have the power, on an application by a defendant (and provided that evidentiary requirements are met), to order a plaintiff to provide security for costs. This security is only released to a defendant, upon successful defence of the claim, and provided that the appropriate cost orders have been made.

As previously discussed, class actions, allow ordinarily impecunious claimants to commence court action. It therefore follows that an order for security for costs against single members of the class action would be viewed as unreasonable. This also results in a rather difficult position for the respondent.

The Federal Court Rules (O28 r3(1)(b)) provide that the court may, in considering an application for security for costs, under s56 of the *Federal Court Act* review:

*“.. (b) that an applicant is suing, not for the applicant's own benefit, but for the benefit of some other person and the Court has reasons to believe that the applicant will be unable to pay the costs of the respondent if ordered to do so.  
...”*

In the circumstance of class action proceedings involving litigation funders, the members of the class are not suing for their benefit alone. The action will result in a benefit for the litigation funder also, often for a significant sum of money.

The question then arises as to whether or not the litigation funders should be ordered to provide such security. It is within the courts power to make such an order and it regularly does, often against the litigation funders directly.

However, a question remains unanswered by the legislature as to whether this should be the “rule” that in all circumstances litigation funders should be required to provide for such security upon commencement of class action proceedings.

#### **4.7 Disclosure of insurance policies**

Two class actions against Centro, a listed property company, are currently on foot. Those actions are being run by Slater and Gordon and Maurice Blackburn.

Maurice Blackburn's class action involves 1349 group members, among them major institutional investors. The investors held more than 178.4 million Centro Property Group securities and more than 549.2 million Centro Retail Trust stapled securities.

Maurice Blackburn's damages claim is based on the difference between the price at which the securities were purchased and the price at which they were later sold or their present value. Around \$432 million in damages has been sought from head stock Centro Properties Group, while about \$537 million is claimed from the retail trust.

These amounts do not include interest and legal costs. The action is being funded by the litigation funding firm IMF and is expected to cost more than \$10million to run.

The second class action, run by Slater and Gordon, now has more than 5,000 members, mostly “*mums and dads*” and other small investors.

The actions both claim against the Centro Properties Group and Centro Retail Trust for their alleged engagement in misleading and deceptive conduct, and disclosure breaches in relation to the financial position of the companies between 9 August 2008 and 15 February 2009. In effect, the companies failed to disclose a \$450 million funding hole which would have rendered the companies unable to pay its short-term debts.

The Federal Court in Melbourne heard an application by Maurice Blackburn, that neither the Centro Properties Group nor the Centro Retail Trust (which recently announced combined half-year losses of more than \$4.4 billion) would be able to make payment of any negotiated settlement.

The firm asserted that it needed to inspect the insurance documents ahead of a forthcoming mediation.

Law requires Centro to hold indemnity insurance, but Maurice Blackburn wants to know if payouts are limited. Centro lawyers opposed access to insurance documents, claiming it would give Maurice Blackburn an unfair advantage in settlement negotiations.

His honour Justice Ryan reserved his decision.

## **5. Conclusions**

### **5.1 General Observations**

Past experience suggests that those who seek to commence class actions in Australia, are influenced by the patterns of activity in the US.

If this experience is replicated, we can expect to see a steady increase in securities and shareholder class actions in Australia, in particular arising out of the turbulence of the current credit crunch.

A distinguishing feature of the present period from the relatively recent past is that formerly there was a greater restraint on the extent to which class action funders could participate and control Australian class actions.

The key litigation funders now assert broad control as a result of High Court and other case authority in recent years. In our assessment, there is certainly a discernable preference for the funding of security and shareholder class actions by the professional litigation funders over any other form of class actions.

That said, historic patterns show that the level of class action activity in Australia is likely to remain a fraction of that seen in the US.

In the field of government inquiries and regulatory investigations, it is reasonable to expect that there will be some mirroring by Australian regulators in due course of, at least, some of the general topics of inquiries and investigations now being undertaken in the US. The outcome of these inquiries and investigations may well increase class action activity in Australia.

### **5.2 Implications for insurers**

Specifically for insurers apart from being aware of a general environment conducive to class actions, including the audacity of current claimants to request copies of insurance policies, there are a number of practical issues for underwriters:

- (a) Those underwriters who are providing cover at defence cost level need to ensure their wording clearly reflects the circumstances in which defence cost cover is to be advanced and aggregate limits bearing in mind class actions not only exist but related criminal prosecutions and inquiries take place that often involve an investigation of the same facts.
- (b) Often there are many classes of an insured party who require representation and the policy should clearly spell out whether there are separate entitlements to cover for each party "*insured*" who seeks representation.
- (c) Similarly, bearing in mind the interplay of criminal and civil proceedings communication is important between insurer and insured so an insured's disclosure obligations should be clearly spelt out.
- (d) A common regret of insurers is the absence of a right to control the conduct of the defence of litigation. For those merely providing defence costs cover this leads to frustration over defence costs being incurred.

- (e) The frustration turns to dismay for those parties who do not have a right to control the litigation where they have in place policies that cover loss and damage, the compensation part of the class actions.
- (f) One category of insurer who is particularly vulnerable is the excess insurer who has been not aware until a claim is about to settle or has been settled that its policy and the policies below give an insured the right of complete control of the litigation, no contractual obligation to keep the insurer or excess insurers informed about the progress of the litigation etc. Vigilance on underlying policy terms in these respects is strongly recommended.
- (g) In class actions there are obviously going to be serious issues for insurers about limitations of liability. Important aspects of the policy that need to be considered are claim definitions, claim aggregation clauses (act, acts, series of, or related or similar acts, etc), limits of indemnity, reinstatement terms, etc.
- (h) It can be expected that those who bring class actions are sophisticated enough to have a general understanding of policy coverage and to frame their claims in such a way as to avoid typical exclusions.
- (i) Adequate rating of a risk. I am reliably informed that the D & O premium pool in Australia is in the order of \$250 million Australian dollars yet the outstanding reserves on claims is in the order of \$2.5 billion. On the face of these figures it does not appear that all insurers are reaping profits from some classes of risk that face class actions exposure.
- (j) As a final point will insurers use litigation funders to prosecute recovery claims against their parties in return for giving a slice of the recovery pie to the litigation funders?