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Shareholder class actions in Australia

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Shareholder (or securities) class actions are now an established part of the Australian legal landscape.

The first shareholder class action in Australia was commenced in 1999. Since that time, more than 50 shareholder class actions have been commenced, but only two have been the subject of a full trial and none have proceeded to final judgment. Most claims have settled in the lead-up to trial as both parties weigh up the uncertainties and risks associated with a judgment (and the costs of trial).

This paper outlines some of the key issues and trends in Australian shareholder class actions.

For more details on class actions in Australia, see our separate note on that topic entitled 'Class Actions in Australia' (which is available on our website).

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Claims made in shareholder class actions

The claims typically made in Australian shareholder class actions relate to the circumstances in which shares (or other equity securities) are acquired and/or sold. The most common claim is that, because of alleged illegal conduct by the company (and/or other defendants), claimants either:

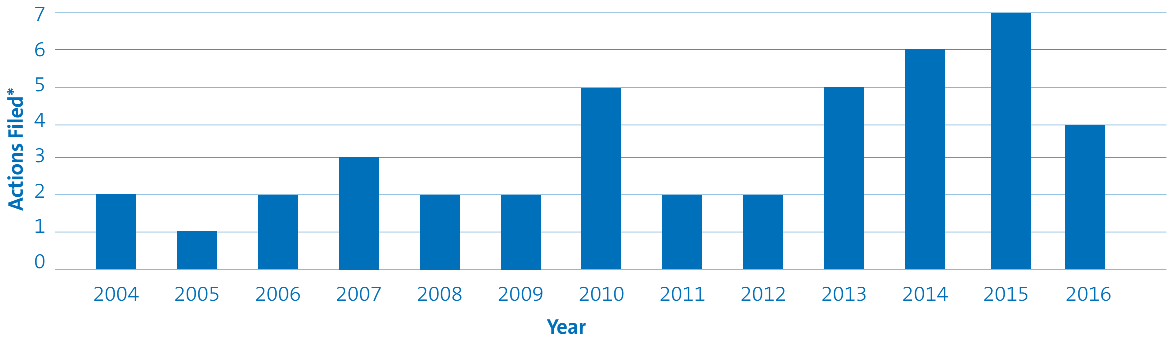
- acquired shares (or other equity securities) when they would not have done so but for the alleged conduct; or
- acquired shares (or other equity securities) at a higher price than they would have otherwise paid but for the alleged conduct.

The causes of action which form the basis for most Australian shareholder class actions are:

- misleading or deceptive conduct in respect of inaccurate or incomplete statements and/or a failure to disclose or correct certain information; and
- breach of a listed company's continuous disclosure obligations.

Importantly, neither of these causes of action requires proof of intent to mislead or defraud shareholders.

The shareholder class actions landscape



*Multiple claims brought by different law firms arising out of the same, or similar, circumstances are treated as a single claim.

By about the mid-2000s, there was talk of an 'explosion' of shareholder class actions in Australia. There has not been an explosion but, as the graph above shows, there has been a marked increase in the number of shareholder class actions commenced in recent years.

Australia is now the jurisdiction outside of the United States in which a corporation is most at risk of facing class action litigation. Shareholder claims account for more than 20 per cent of all class action filings in the last decade. The increase in the number of shareholder (and other) class actions commenced in recent years is largely a result of the confluence of the following circumstances:

- plaintiff law firms have focused on shareholder class actions as a significant business opportunity (particularly in the wake of the downturn in their personal injury practices following legislative reform);
- the acceptance of the validity of, and growing facilitation of, third party funding under Australian law (as discussed below);
- a growing focus on corporate governance and the role that private litigation can play in the enforcement of corporate law; and
- the introduction of, and amendment to, court procedures, rules and regimes designed to facilitate the bringing of class actions which have resulted in new players entering the market, and the Australian class action regime being described as 'one of the most liberal class action rules in the entire world'[1].

It has become increasingly common for multiple shareholder class actions to be commenced by different law firms in relation to the same conduct. This issue is most frequently addressed by arranging for the cases to be managed and heard together rather than, for example, staying one case and allowing the other to proceed. While resulting in many synergies, this approach often still requires a defendant and the court to deal with separate pleadings and evidence and, as such, significantly increases the costs compared to dealing with a single claim.

There has also been growing acceptance of shareholder class actions in the Australian investment community, including among institutional investors. Although an institutional investor rarely takes on the role of representative plaintiff, institutional participation has become increasingly fundamental to the commercial viability of many shareholder claims. Moreover, the sheer size of many institutional holdings in major listed companies means that growing institutional participation has increased the potential exposure associated with many shareholder class actions.

Some of the more high-profile shareholder class actions are profiled in the table that follows.

1 Professor G Miller, 'Some Thoughts on Australian Class Actions in light of the American Experience' in the Hon Justice K E Lindgren (ed), *Investor Class Actions*, Ross Parsons Centre of Commercial, Corporate and Taxation Law (2009) 2 at 4.

Case	Commenced	Description	Outcome / Status
Aristocrat	2003	Shareholders alleged that the company's financial accounts were incorrect due to the inclusion of certain revenue in circumstances not permitted by accounting standards and that the company did not have reasonable grounds for statements made about its expected profitability.	The case settled in August 2008 after trial (but before judgment) for $136 million plus $8.5 million in costs.
Multiplex	2006	Shareholders alleged that the company did not properly disclose the full extent of significant cost increases and delays (or the risk of significant cost increases and delays) in the construction of the Wembley Stadium.	The case settled in July 2010 (three months prior to trial) for $110 million (including costs).
AWB	2007	The shareholders' claims were based on an alleged failure to disclose AWB's payment of transportation and handling fees to an Iraqi entity in circumvention of UN Security Council resolutions and the making of allegedly misleading or deceptive statements in relation to the company's dealings in Iraq.	The case settled in February 2010 (three days into the trial) for $39.5 million (including costs).

Case	Commenced	Description	Outcome / Status
Centro	2008	Investors alleged that the Centro companies did not adequately disclose the full extent of their maturing debt obligations and the risk that they might not be able to refinance those debt obligations at forecast cost or at all.	The case settled in May 2012 (midway through the trial) for $200 million (including costs).
National Australia Bank	2010	Shareholders alleged that the Bank failed to disclose provisions for losses (or the need for such provisions) in respect of its exposure to over $1 billion of CDOs in the first half of 2008 (ie during the development of the global credit crisis).	The case settled in November 2012 (weeks before trial) for $115 million plus $12.5 million in costs.
Sigma Pharm-aceuticals	2010	Shareholders alleged that the company did not have a reasonable basis for its 2009 profit guidance and that it failed to disclose the deterioration in its share of the generic pharmaceuticals market.	The case settled in October 2012 (a year prior to trial) for $57.5 million (including costs).
GPT	2011	Shareholders alleged that GPT did not provide timely disclosure of price-sensitive information in relation to its 2008 results after a significant earnings downgrade (as against earlier market guidance) was announced on the eve of the end of the results period.	The case settled in May 2013 after trial (but before judgment) for $75 million (including costs).
Allco Finance Group	2013	Shareholders allege that the company failed to accurately disclose the level of its current liabilities and failed to inform the market of a review clause in its lending facilities.	The trial is expected to commence in October 2016.

Third party litigation funding

In 2006, the High Court of Australia gave its approval to the concept of third party funding when it found that it was not contrary to public policy or an abuse of process (although individual funding arrangements may still fall foul of those imperatives)[2]. The ruling removed the questions surrounding the validity of third party funding that had previously existed and has encouraged new funders to enter the Australian market[3]. More than triple the number of class actions were commenced in the three years following the decision than in the three years prior[4]. It is now highly unusual for shareholder class actions to be pursued without third party funding.

Following further recent developments in the law relating to third party funding, funders are not subject to any regulation beyond the general law (to the extent the funder is subject to Australian law) and the need to have adequate processes in place for managing conflicts of interest. This means that anyone can fund litigation except for the lawyers involved in the case (who are prohibited from entering into an arrangement that involves taking a share of the proceeds of the litigation). That position is, however, under review following an inquiry by the Productivity Commission into 'Access to Justice Arrangements'. In December 2014, the Productivity Commission recommended that third party funders should be subject to a licensing regime which focusses on capital adequacy and disclosure requirements.

In November 2016, litigation funders achieved a significant breakthrough in the form of a so-called 'common fund' order[5]. This order entitled the funders in a shareholder class action to receive a funding commission from all participating class members and not just from those who had signed funding agreements. The court will not, however, determine an appropriate funding commission until the end of the proceedings. The introduction of this element of uncertainty has meant that the decision has been met with mixed responses from the funding sector. It remains to be seen what impact it will ultimately have on the shareholder class action landscape.

For further discussion of third party funding in Australia, refer to our more general paper on class actions in Australia.

Causation – is actual reliance required?

Causation is an essential element of a claim for damages arising from both misleading or deceptive conduct and a breach of a listed company's continuous disclosure obligations.

A critical unresolved issue in shareholder class actions in Australia is what a claimant must do to establish causation[6]. In particular, whether:

- it is necessary for each claimant to prove actual reliance on the contravening conduct (direct causation); or
- the requirement can be satisfied by general notions of reliance by the market affecting the price at which each claimant purchased and/or sold their shares (or other securities) (market-based causation).

Whether or not direct causation is required will determine the process by which claims are dealt with

2 *Campbells Cash and Carry Pty Ltd v Fostif Pty Ltd* [2006] HCA 41.
3 See Allens *Focus*: 'High Court gives green light to litigation funding' (August 2006) www.allens.com.au/pubs/ldr/foldr30aug06.htm
4 Morabito V., 'An Empirical Study of Australia's Class Action Regimes: Class Actions Facts and Figures' (December 2009).
5 *Money Max Int Pty Ltd (Trustee) v QBE Insurance Group Limited* [2016] FCAFC 148
6 See Ross Drinnan and Jenny Campbell, 'Causation in Securities Class Actions', *University of New South Wales Law Journal*, Volume 32, Number 3, 2009, 928.

following the determination of the common issues. That is, whether:

- those claims can be dealt with together with causation essentially being presumed; or
- each claimant must come forward individually to establish that the company's contravening conduct caused their loss.

For that reason, the determination of this issue will have significant ramifications for the way in which shareholder class actions are structured in the future and, ultimately, whether they remain a viable business proposition for plaintiff law firms and third party funders.

In the United States this issue has been addressed in the context of Rule 10b-5 by the fraud-on-the-market theory. Based on the hypothesis that, in an efficient stock market, the price of a company's securities is determined by the available information regarding the company, the theory is that a misleading statement or omission will defraud purchasers of the securities by inflating the purchase price whether or not the purchaser directly relies on the misstatement or omission. Consequently, where a person deals in a company's securities on an efficient market, there is a rebuttable presumption of reliance (and therefore causation) arising from the market's presumed reliance on the accuracy and completeness of the information disclosed by the company.

Despite parallels between the fraud-on-the-market theory and market-based causation, Australian litigants have taken the approach that the issue should be determined by reference to established Australian law principles of causation and without the Court having to establish any new law (such as introducing the fraud-on-the-market theory into Australian law).

After more than a decade of uncertainty, in April 2016, Justice Brereton of the Supreme Court of NSW gave the first decision on this issue in a shareholder claim against HIH Insurance Limited.[7] In that case, the Court held that the shareholders could prove causation by establishing that the price of the shares they bought was 'inflated' by a company's misleading statements. Although the case was not a class action, it involved 117 shareholders and was no different to a class action in this respect.

The principal allegation in that case was that the shareholders acquired HIH shares in certain periods between 1998 and 2001 during which the price for those shares was inflated by misrepresentations contained in HIH's FY1999 and FY2000 results. Importantly, the shareholders did not contend that they directly relied upon (or even read) the reports of the financial results. But rather, relying on a theory of market-based causation, they claimed that:

- they acquired shares in a market which was distorted by HIH's misrepresentation of its financial results;
- that distortion resulted in HIH's shares trading at prices higher than they would have traded if the misrepresentations had not been made; and
- they suffered loss because they paid more for their shares than they would have otherwise had to pay.

In order to recover damages, it was necessary for the shareholders to establish that they had suffered loss or damage 'by' the contravening conduct. In considering whether the plaintiffs' market-based causation case satisfied that requirement, Justice Brereton said that a sufficient causal connection can be established in ways that do not involve the plaintiff directly relying on the contravening conduct.

While the contravening conduct did not directly mislead the shareholders, it deceived the market (constituted by investors, informed by investors and advisers) in which the shares traded and in which the plaintiffs acquired their shares.

In those circumstances, his Honour concluded that market-based causation is available and that the absence of direct reliance by the plaintiffs on HIH's misleading accounts did not preclude them from recovering their losses:

- so long as it could be proved that the market price for HIH shares during the relevant period was 'inflated' by the contravening conduct; and
- in circumstances in which there was no suggestion that the plaintiffs knew the truth about (or were indifferent to) the contravening conduct, but proceeded to buy the shares anyway.

This is a significant decision on the approach to causation. The question will not, however, be finally resolved until it has been considered by the High Court and until that time it will still be considered an open question by plaintiffs and defendants.

Looking forward

It is likely that we will see more shareholder class actions commenced in Australia in the years to come (as part of the continued growth of the broader Australian class action landscape). The precise form future shareholder class actions take and how prevalent they become is likely to be determined by how the question of causation is eventually resolved.

7 [2016] NSWSC 482.

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