

INVESTOR CLASS ACTIONS

*An address given by The Hon Murray Wilcox QC on the occasion of the launch of the book **Investor Class Actions** at the Federal Court in Sydney on 3 August 2009.*

I congratulate those responsible for the publication of *Investor Class Actions*. This little book gathers together the text of five papers given on 10 March 2009 at a conference in this place; with a video link to Melbourne. It also includes the discussion that took place after delivery of the papers.

The sponsors of the conference were the Federal Court of Australia, the Ross Parsons Centre of Commercial, Corporate and Taxation Law at the University of Sydney and the Business Law Section of the Law Council of Australia. No doubt many people contributed to the success of the conference; I am sure, none more so than Justice Kevin Lindgren, who has also edited the book. I know I speak for all of you in congratulating Justice Lindgren on his achievement.

Video-linked conferences

The book's Introduction, written by Justice Lindgren, reveals that the March conference was not the first occasion upon which the Court has successfully conducted a video-linked seminar or conference. I emphasise the word 'successfully' because I well recall an occasion, during my time, when we tried to conduct a Sydney-Melbourne seminar about querulous litigants, only to find ourselves repeatedly losing our increasingly querulous Melbourne colleagues. It seems the technology has since improved.

As was demonstrated by the two 2008 seminars mentioned by Justice Lindgren, it is now possible to have participation in a conference or seminar by people in all eight of the Court's Registries. This is gratifying. The Court is a national court. Subject to the problem of time differences, I hope seminars and conferences will regularly be made accessible in all eight registries of the Court.

The papers

The first paper is written by Professor Geoffrey Miller of New York University. It describes recent American experience in relation to class actions and, very usefully for us, compares the scheme of our legislation with that of the judge-made Rules that govern class actions in American courts. The good news is that we come out well from the comparison. However, in my opinion, the bad news is that we no longer abide by the intendment of our legislation. I will come to that later.

The second paper was given by Professor Tyrone Carlin, Professor of Financial Reporting and Regulation at the University of Sydney. He deals with aspects of the relationship between financial reporting and investor class actions. This is likely to be essential reading for lawyers preparing some investor class actions.

The third paper, by Associate Professor Vince Morabito of Monash University, contains an analysis of *King v. GIO*, Australia's first shareholder class action. As the professor demonstrates, the rulings given in that case seem to have settled several controversial matters, but given rise to others.

Dr Peter Cashman was one of the principal authors of the ALRC report on class actions. (We called them "group proceedings" in an attempt to allay the paranoia of those in the Australian business community who thought we were trying to import, holus-bolus, American style class actions). Dr Cashman has had experience at the class action coalface, having practised in this field as a solicitor over a number of years. He has teamed with Mr Ross Abbs of Sydney University to prepare the fourth paper, a sobering piece called: "Prospects and problems for investors in class action proceedings."

The final paper is that of Mr Ashley Black, a solicitor experienced in the conduct of class actions on behalf of respondents. He bravely undertook to comment on the other four papers and, as WS Gilbert might have said, he "did it very well". His paper is full of worthwhile reflections.

I suspect Justice Lindgren asked me to launch the book because he thought I might throw a few rocks around. You would not wish me to disappoint him. Comments might usefully be made about many topics, but I will limit myself to two core problems.

The American experience: turning the legislative scheme on its head

Professor Miller's discussion of the United States requirement of certification illustrates, yet again, the capacity of lawyers to turn a legislative scheme on its head. The professor said "the class certification decision in US practice is, in theory, supposed to be something that happens very early in the proceeding." (page 5) However, he explained, the current practice is the direct opposite: the plaintiff's lawyer usually does not apply for certification until the case is settled.

Professor Miller said the current position is a result of a change, in the last five to ten years, in the practice concerning appeals against certification decisions. Until recent times, such decisions were regarded as virtually unappealable; any appeal would involve review of a discretionary judgment. Now, it appears, appeal courts regularly intervene and overturn certification decisions.

I need not discuss either the cause or consequences of this new approach; they are United States problems. I wish, however, to discuss one comment of Professor Miller that may have Australian ramifications.

Interaction of common and individual issues

Professor Miller set out what the certification rule requires plaintiffs to show (page 5). They include that the common issues predominate over the individual issues. The professor went on to say (page 9):

“Because reliance is an individual issue, it is going to be impossible under the predominance rule to certify the class because the individual issue of reliance will swamp the common issues in the case.”

That seems to be an astonishing position for any court to adopt. I need say no more; in Australia, there is no requirement of predominance. However, at least in the Federal Court, there can be argument about something close to predominance.

The docket judge has a discretion to order the proceeding not proceed as a group proceeding: see *Federal Court of Australia Act 1976* ss. 33M and 33N. Respondents’ representatives frequently ask judges to exercise this power. In doing so, they emphasise the individual aspects of the case; in particular, reliance. They say the proceeding is not manageable as a group proceeding if it will require each group member to establish some individual element; because of the number of group members, the individual elements will “swamp” the common issues.

There are cases where swamping may occur; for example, where the group members rely on oral representations made to each of them, but in different terms in separate conversations. Even though there may be a common issue about an aspect of what was being discussed in each conversation, it may be an unduly complicated process to apply any finding about that aspect to the various conversations.

However, if group proceedings are to remain a useful legal tool, it is important to put swamping claims into perspective.

Soon after Part IVA was added to the *Federal Court of Australia Act*, I was privileged to undertake a one-week course at the United States National Judicial College in Reno, Nevada. The course was entitled: “Managing Complex Civil Litigation.” It was not confined to managing class actions, but class actions were a major focus of the lectures and discussion. The students were mostly American trial judges. The approach was strictly pragmatic.

One of the most useful pieces of advice given to the class came from a Los Angeles law professor who had made a detailed study of the course of some dozen recent complex cases. In each case, there were both common and individual issues. He said that, provided the common issue or issues were substantial, the key to managing a complex case was first to resolve that issue or issues. He said, prophetically in terms of the Federal Court’s later experience: “The defendants will always want to talk about the individual issues and have you start looking at them. They will do that because they know that way the case will become a mess and they will be able to get out of it cheaply. You have to resist that approach and insist on everyone first addressing the common issues.”

The professor took us through the cases he had investigated. They validated his point. In about half the cases, the judge had insisted on first concentrating on the common issues. In each of these cases, the case had proceeded smoothly. In some cases, a critical common issue had been decided against the plaintiff. That was the end of the case; there was no need to consider individual issues. In other cases, the plaintiff succeeded on all critical common issues. With one exception, as I recall, the case

promptly settled; the defendant was not interested in spending more money on a losing case.

The cases in the other half were all disasters. The judge had allowed investigation of individual issues, always on the representation that this would shorten the proceeding. Sometimes this resulted in dismissal of the claims of particular class members, or groups of members, but the other claims were left unresolved. The judge found himself hearing aspects of an endless number of separate claims without ever getting to the element in the controversy that had been thought to justify the earlier certification.

McMullin v. ICI

Not long after I returned from Reno, I had occasion to apply the law professor's advice. It fell to me to manage, and later hear, a group proceeding instituted by two people, husband and wife, who carried on business as graziers, against three companies in the ICI group, the Commonwealth of Australia, a Commonwealth agency (the National Registration Authority) and the States of New South Wales and Queensland.

The applicants alleged their cattle had absorbed a chemical called chlorfluazuron, the active ingredient in an insecticide developed, manufactured and marketed by the ICI companies for use in the cotton industry. As a result of this absorption, they said, their cattle had been rendered unsaleable for a considerable time, causing the applicants significant losses. They alleged misleading conduct and negligence. The group members were not identified by name, but only as people falling into one of seven specified categories of people in the cattle industry.

It was clear that, if misleading conduct were found, it would be necessary for each group member to give evidence of reliance. Even if the claim succeeded only on negligence, each group member would have to prove his/her damage. The respondents had also filed a raft of cross-claims.

With the law professor's advice ringing in my ears, I ruled we would not consider these matters at that early stage; but, rather, concentrate on the hotly-contested common liability issues: see *McMullin v. ICI Operations Pty Limited* (1996) FCA 1878.

I did deal with applications for summary dismissal, on behalf of the Commonwealth and the National Registration Authority (successful) and the two States (unsuccessful); but they were the only preliminaries to a trial of the case made by the applicants against the various respondents on liability, leaving aside the issue of reliance.

The liability trial occupied 20 days. The focus was on the conduct of the respondents, something that was common to all the claims.

In a reserved judgment (reported at (1997) 72 FCR 1), I made findings against the three ICI companies, but only in respect of the group members who fell into four of

the seven categories. The liability findings were based on negligence, not misleading conduct. Consequently, reliance disappeared from the case.

I dismissed the claims against the two States.

Nobody sought leave to appeal against those findings. Had it been sought, I would unhesitatingly have granted leave. It was essential to obtain certainty about these findings before other steps were taken.

Once it was clear there would be no appeal, I fixed a date for trial of all the cross-claims. Before that date, and in the light of my findings on liability, many of the cross-claims were discontinued. A few remained but, by lunchtime on the second day, these had all settled.

At this stage, there was still no list of class members. However, the parties knew the identity of many of them. With encouragement from me, they adopted a protocol for exchanging information about each claim, supported where possible by relevant documents. Each side engaged a claims assessor with agricultural experience. Most of the claims were resolved between the assessors. A Court-appointed mediator assisted in a few cases. A handful of claims remained unresolved. A judicial registrar heard most of these. I heard a few claims, that were said to involve a point of principle.

During the damages negotiation period, the parties raised with me the need to close the class; otherwise the parties would never know when the case was over. I directed publication of newspaper notices requiring those who had not yet done so to submit their claims within, I think, three months. I thought it important that the time be not too short. It was necessary to allow for people being away from home, distracted by illness, other business, personal matters etc

When the class finally closed, it transpired there were 499 claimants (individuals, partnerships and companies). I was told the total damages payout came to nearly \$100 million. Bearing in mind that each damages claim was necessarily different from each other claim, the court time spent on damages assessment was minimal. The reason, of course, was that the respondents knew they would be paying the costs of any damages hearing unless the relevant group member had made an unreasonable claim; and the applicants' solicitor had warned group members against doing this.

This case seems to have been forgotten, even by the encyclopaedic Professor Morabito. It does not make his list of Australia's "most significant class proceedings" (page 37) even though it involved payouts to more group members than either *Aristocrat* or *Longford*, which do.

I mention the case, not because of my affection for it, but because it demonstrates the wisdom of the advice given to me long ago in Reno: do not be distracted from first concentrating on the common issues. Sadly, this wisdom seems today often to be overlooked. The papers of Professor Morabito and Dr Cashman both suggest judges sometimes heed the call of parties to concern themselves with other matters before they have resolved the common issues that are fundamental to the case.

Opt-out becomes opt-in

A fundamental issue for the ALRC was whether to recommend an “opt-out” or an “opt-in” system. The issue was enormously contentious. Knowing the average Australian’s propensity to inertia, where bureaucratic and legal matters are concerned, those representing prospective defendants lobbied hard to have the ALRC adopt an “opt-in” rule. They failed because the ALRC thought this would have only limited value.

An “opt-in” rule would have overcome the decision of the English Court of Appeal in *Markt & Co Ltd v. Knight Steamship Company Ltd* (1910) 2 KB 1021, but that is all it would have done. To the extent that a plaintiff’s lawyer knows the names of other potential claimants, those people can always be made co-plaintiffs. It was not necessary to introduce a new procedure in order to get rid of *Markt*; a simple statutory amendment would have sufficed.

The ALRC thought an “opt-out” rule, by contrast, would better achieve the two classic aspirations of the class action: to deter misconduct, generally by corporations, and to provide redress for all those who suffer damage as a result of misconduct, whether or not their identity is yet known, and whether or not they are well-informed, legally sophisticated people able and willing to take active steps in relation to the proposed claim.

The ALRC preference for an “opt-out” rule dismayed the prospective defendants’ representatives. They turned their lobbying machine onto the government of the day. To no avail; on this issue, the government agreed with the ALRC.

However, the defendants’ representatives have now prevailed. As is made apparent by the papers of Professor Morabito and Dr Cashman, in virtually all significant commercial cases (at least), we now have an “opt-in” class action system; the statutory scheme has been subverted. How did this come about?

In enacting Part IVA, the government chose not to establish the group proceeding fund recommended by the ALRC. This left prospective group representatives without any source of the funds necessary to defray the cost of the proceeding, or to meet an adverse costs order; and this in a context where the representative party gained nothing (except extra trouble and expense) by bringing a group proceeding rather than an individual action. When I learned there was to be no fund, I thought there would be no group proceedings.

However, I had overlooked the entrepreneurial spirit of the legal profession. I should not have done so. There has always been a group of solicitors, with supporting barristers, who are prepared to take on good looking cases on a speculative basis, regarding themselves as sufficiently rewarded by the party-party profit costs and what is (hopefully) a not exorbitant solicitor-client charge. Although I was never told, I have always assumed this is what happened in *McMullin*. As appears from Professor Morabito’s paper (pages 36-37), it is certainly what happened in several early cases, including *King v. GIO*.

Sadly, it quickly became fashionable for parties, especially respondents, to pepper the docket judge with interlocutory applications about all sorts of questions and often to appeal the judge's rulings on them.

Under the heading, "Interlocutory Warfare", Professor Morabito has told us the position in *King v. GIO* (pages 47-50). There is no reason to regard that case as atypical. By March 2003, still 14 months before the fixed hearing date, there had been 20 interlocutory judgments, 14 by Moore J (the docket judge), three by the Full Court and three by other single judges. Even earlier than that, in July 2002, a partner in the applicant's firm of solicitors had told Moore J the firm had already outlaid almost \$5 million in costs. When the case was eventually settled, before the hearing, the approved settlement gave the applicant's solicitors over \$15 million.

It is unsurprising that ballooning costs of group proceedings have suppressed solicitors' entrepreneurial elan. They have become nervous about the extent of their risk and have sought to cover themselves by obtaining funds from those who would benefit by success in the action. They have asked group members to enter into costs agreements, despite one of the fundamental assumptions of Part IVA being that a group member would not be made liable to contribute to the costs of the proceeding, except by order of a judge for exceptional reasons.

But if some group members were contributing to the costs of the proceeding, how fair was it that others did not? Put another way, from the solicitors' point of view, how could they persuade group members to sign a costs agreement unless they could threaten them with exclusion if they did not? So was born the concept of an element in the group definition being that each member had entered into a costs agreement with the solicitors for the representative party.

Australian lawyers have demonstrated they are not behind their American cousins in turning a system on its head: opt-out has become opt-in. And this largely, in my respectful opinion, because the judges have exhibited far too much tolerance of the swarm of interlocutory applications and applications for leave to appeal that so often have resulted in enormous pre-trial costs outlays.

What are we to do?

It seems to me there are presently two fundamental problems in relation to the conduct of Federal Court group proceedings. I have just mentioned one of them: too much judicial tolerance of interlocutory applications and applications for leave to appeal interlocutory decisions.

All judges should remember the golden rule: when managing a class action, concentrate on those issues that are common, and central, to the claims of all parties. If a party makes an interlocutory application concerning some other matter, it is open to the judge, and ordinarily desirable, for the judge to stand it over until after determination of the common issues. Chances are it will never come back.

In relation to applications for leave to appeal, it is better for dubious exercises of discretion to be allowed to stand rather than for the Court to allow an appeal culture to develop. This involves Full Courts having enough restraint to refuse leave to appeal

even though each of its members might feel that, if he or she been the docket judge, he/she would have handled the matter differently. This is, indeed, supposed to be the law, in relation to discretionary judgments; but, human nature being what it is, it is difficult for appeal judges to resist the temptation to intervene.

Even more serious is the problem of funding. Although I deplore that we have arrived at an opt-in system governed by subscription to solicitors' costs agreements, I find it difficult to criticise the solicitors for developing that system. They have had little choice. There is a clear need for an alternative.

Although opting-in was achieved in a different way in *King v. GIO*, the figures quoted by Professor Morabito are instructive. He tells us (page 52) that 17,826 group members (26.49%) filed opt-out notices. So the total class must originally have numbered about 73,000 people. After the series of notices that effectively substituted an opt-in regime, only 23,099 class members (about 31%) were left to share the settlement spoils. Of these, 21,142 people had entered into costs agreements with the solicitors. Only 1,957 of the approximately 32,000 people who had not filed opt-out notices, but were unrepresented, returned the opt-in form. This was a response rate of about 6%. Those that fell by the wayside assuredly included a high number of the less sophisticated people the opt-out system was designed to protect.

I doubt that any government will ever be willing to establish a class action fund. In order to cover the possibility of an early expensive loss, it would be necessary for the government to provide capital amounting to tens of millions of dollars. It is unrealistic to believe any government will do that; there are many more pressing needs.

At one time, I was attracted to the idea of a fund created by a professional body, such as the Law Council of Australia. The fund's board could consider applications for funding. If an application were approved, solicitors would be engaged to conduct the case, working at agreed rates regardless of the outcome. The fund would take a percentage of any recovery, the residue being paid to group members.

However, there are difficulties about this model. First, would any professional body ever assemble enough money to establish the fund? Second, the board members would bear an enormous responsibility in circumstances where they could not give the case more than part-time attention.

What about private funding on a percentage basis? Our law has always set its face against contingency fees. This has been because of concern that solicitors' professional integrity may be undermined by them having a financial interest in the outcome. But surely that concern is open in a case, like *King v. GIO*, where the solicitors have invested millions of dollars on a speculative basis. If it were possible to divorce funding from the conduct of the case, there would be less room for concern.

There should not be open slather. This option should be available only to litigation funders that have satisfied the Court, in the particular case, of their probity and financial integrity and that there is no financial connection between them and the solicitors they intend to engage to conduct the case. Once approval was granted, the litigation funder would engage those solicitors, paying fees calculated at usual rates

regardless of the result of the case. The litigation funder should be required to indemnify the representative party against any adverse costs order and to provide any security for the costs of a respondent that might be ordered by the Court. The legislation could provide that, in return for all this, in addition to any party/party costs ordered to be paid to the applicant by another party, the litigation funder would be entitled to receive a percentage of the total recovery calculated in accordance with a sliding scale: for example X% of the first \$10 million, Y% of the next \$40 million, Z% of the next \$50 million and so on. The percentages would need to be carefully considered by a working party concerned to provide a viable system that is nonetheless fair to group members.

It may be objected that a percentage scale would take no account of the amount of work, and risk, involved in the case. That is so. However, in relation to amount of work, the same may be said about real estate agents' commissions. Sometimes a sale comes easily, sometimes it does not. Anyway, the percentages should be selected on the basis that the litigation funder will also have recovered party-party costs, the case (by definition) having been won. Party-party profit costs, of course, reflect the amount of work done in connection with the case. As far as risk is concerned, that will be something for the litigation funder to assess. Only strong cases will be taken on. That is as it should be.

One of the advantages of my proposal is that it would bring to an end the invidious situation that currently arises when a court is asked to approve a settlement of a group proceeding. The judge is told how much will be received by group members. The judge may (should, in my opinion) inquire how much is to be paid to the applicant's solicitor in costs. However, unless the judge requires production of an itemised bill of costs, and has this assessed by an independent person, the judge has no way of knowing whether the agreed sum is no more than fair remuneration for work done or whether it contains a sweetener to procure the solicitor's agreement to the sum offered as damages for the group. It is inherently unsatisfactory that a solicitor should simultaneously be engaged in negotiations with the same person about his/her clients' interests and his/her own interests.

Is there any merit in my suggestion? Are there better ways of overcoming the problems I have discussed? Would it be a good idea for the three sponsors of the 10 March conference to establish a working group charged with the task of examining these issues and perhaps putting a proposal to the Government for amendments to Part IVA? Over to you to consider. Your consideration will be facilitated by the excellent papers in *Investor Class Actions*, which I hereby launch.

Murray Wilcox

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<http://www.law.usyd.edu.au/parsons/publications/monographs.shtml>

For any further queries please contact: law.parsons@usyd.edu.au +61 2 9351 0385