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'Recent Developments in Financial Services Class Actions in Australia'

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Class actions have been a part of the Australian legal landscape for 25 years.
Originally, the prevailing expectation was that much of the Court's business would take the form of product liability based class actions, as well as and shareholder and investor claims. But over time, the focus has shifted and diversified across a wider range of claims, from natural disasters, constitutional law and human rights abuses to climate change and other environmental claims.[1]

The past decade or so has witnessed several significant developments that have positively impacted upon the viability of class actions in Australia, including but not limited to the development of third party litigation funding. These developments have been most felt in the area of financial services (or investor) class actions, many of which emerged out of claims that were revealed in the aftermath of the Global Financial Crisis.

What is a class action?

In Australia, the expression *"class action"* is a generic reference to *"representative proceedings"* commenced under Part IVA of the *Federal Court of Australia Act 1976* (Cth). Similar regimes have been established in Victoria[2] and New South Wales[3]. For convenience, this paper is given by reference to the Commonwealth scheme only.

Thus understood, *"class actions"* are a procedural device whereby the claims of many individuals against the same defendant can be brought and conducted by a single representative, in circumstances where individual claims would not otherwise be viable due to the disproportionate costs of litigation.

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[1] eg., see discussion in *'Reflecting on 25 years of class actions in the Federal Court of Australia'*, Gill & Biddle (2017) AILB 58

[2] Pt 4A of the *Supreme Court Act 1986* (Vic)

[3] Pt 10 of the *Civil Procedure Act 2005* (NSW)

In *AS v Minister for Immigration and Border Protection*[4], Kaye J (as his Honour then was) expressed the *raison d'etre* for class actions as follows (at [54]):

> *A group proceeding is intended to be a facilitative process, so as to provide a cost effective method by which a large number of persons, who might otherwise be unable to do so, might have access to justice. It is a convenient procedure which can promote efficiency in the administration of justice, avoid inconsistent judgments, and obviate the re-litigation of common questions of fact in large numbers of separate proceedings.*

See also *Giles v Commonwealth*,[5] where Garling J refers to many of the recognised advantages and benefits of class actions, whilst also pointing out some of the disadvantages.

In this context, it is important to recognize that *"class actions"* as commonly understood in the United States[6] differ in many significant respects to class actions in Australia, including the qualifying criteria, certification and costs implications.

Financial services - fertile ground for class actions

The expression *'financial services'* is very broadly defined in the *Corporations Act 2001*, but so as to contain this presentation within manageable boundaries, for present purposes I am referring to retail investments in collective investment schemes, debenture schemes and superannuation funds, as well as the provision of corresponding investment advice to such investors. Of course, much of this may be equally applicable to class actions that can (and do) arise in the banking and insurance sectors and the so-called professional and institutional investment markets.

The financial services arena is, and will likely remain, a fertile source of class actions in Australia. The reasons for this are manifestly obvious to any reasonably well-informed participant or observer with an ordinary comprehension of human nature, especially if they have some appreciation of the evolution and operation of democratic capitalist economies over the past couple of centuries.

According to one industry source, in Australia at least 155 managed investments schemes with an original value of about $36 billion failed or were frozen between January 2006 and late 2012.[7] A plethora of related class actions on behalf of mostly retail investors has been

[4] *AS v Minister for Immigration and Border Protection*[4] [2014] VSC 593
[5] *Giles v Commonwealth* [2014] NSWSC 83 at [80]-[82]
[6] ie. the regime established by *Federal Rules of Civil Procedure* (US), r23
[7] Association of Independently Owned Financial Planners, January 2013

working its way through the Courts ever since. Many debenture schemes suffered a similar fate around the same time, and have likewise been populating the Court lists in both Federal and State jurisdictions.

As was pointed out by Professor Pamela Hanrahan more than a decade ago in her authoritative work, *'Funds Management in Australia'*, by surrendering control of their investment to a scheme operator (or debenture-issuing company), collective investors expose themselves to the risk that the operator will neglect their interests either as a result of shirking (that is, a lack of attention or effort) or self-dealing (that is, preferring its interests over those of the investors).[8] No doubt it was considerations of this kind that more recently prompted the extra-curial remarks in relation to retail collective investments by an experienced former judge of the Federal Court, that: *"nobody in his right mind would put two bob"* into managed investment schemes.[9]

In passing, one may be forgiven for concluding that the prevailing regulatory regime has failed, and in its present form, will continue to fail the interests of retail investors. The existing disclosure obligations are designed to ensure that participants in the investment and financial markets are kept fully informed in a timely way about matters that may impact upon the pricing of traded securities which, hypothetically at least, reflect the expectations of traders about their future value. But that disclosure regime is manifestly inadequate as a means of protecting the interests of retail investors against compliance risk or the risk of economic exploitation by the unscrupulous, though legally compliant, scheme operator (especially in relation to unlisted products).

In many if not most situations, even if all material facts were to be fully disclosed, the ordinary retail investor is simply incapable of understanding or analyzing the information so as to gain any meaningful appreciation of the costs, benefits and inherent risks of the contemplated investment. Even their financial adviser, if they have one, may not be up to that task, or may no longer care having already made the sale. And, of course, in relation to unlisted products that information is not implied into a market price.

Arguably, there are compelling reasons for significant regulatory reform in this area.

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[8] P Hanrahan *'Funds Management in Australia'*, LexisNexis, 2007 at [4.5]
[9] *Australian Financial Review*, 10 June 2011, per Finkelstein J

Pre-litigation access to documents

Experience shows that the first hurdle that commonly stands in the way of an embryonic financial services (or investor) class action is the significant information asymmetry as between the prospective claimants and the defendant.

The claimants are usually unsophisticated retail consumers, directly or indirectly, of financial products or services provided by the defendants. The defendant, on the other hand, will invariably have custody and control of much of the critical information that would reveal the relevant factual matrix in which the investors' alleged loss or damage was suffered.

This can give rise to significant difficulties in establishing the existence and precise nature of the claimants' causes of action, as well as whether legal proceedings would be economically viable having regard to prospects of success and the likely quantum of any damages or compensation that may be awarded.

Of course, a range of processes spring readily to mind by which prospective claimants may claim rights of access and inspection of documents, eg:

- preliminary discovery
- inspection of company books & records (s247A *Corporations Act*)
- examinations of company directors & officers (Part 5.9 *Corporations Act*)
- equitable rights to inspect trust documents

However, the prospective defendant will almost invariably have access to substantial financial resources that can be tactically deployed in expensive pre-litigation skirmishes to resist the production of documents and thereby reduce the likelihood of proceedings being commenced and, if that strategy fails, to embark upon an exhausting interlocutory war of attrition. The claimants, by way of contrast, in the absence of third party litigation funding will usually have only very limited resources.

Litigation Funding

It goes without saying that a typical financial services class action will involve the claims of hundreds, if not thousands of group members. The issues of fact and law are invariably complex, requiring the consideration of extensive documentary evidence and the competing evidence of experts across a range of specialised areas of learning and experience. The time, costs and expense of class actions are commonly further exacerbated by defence tactics involving preliminary strike-out applications, repeated attacks on the pleadings, numerous interlocutory applications and intransigent arm-wrestling over the discovery and production of documents. From the commencement of investigations to settlement or final hearing may take many years. Only the deepest of pockets can *"feed the furnace"* of costs and expenses in this kind of litigation.

Over the past decade or so, the role of third party litigation funding has emerged as an important *"gatekeeper"* and economic driver of class actions, and has opened access to justice that, for all practical purposes, did not previously exist.

In Australia, third-party funding of large class actions has gained considerable traction since the High Court's landmark decision in *Campbells Cash and Carry v Fostif*.[10] For those not familiar with that decision, it established that third-party litigation funding was neither impermissible nor an abuse of process or otherwise contrary to public policy, subject of course to the facts and circumstances of each case. The economic viability of third party funding for large class actions was given further impetus the following year, when the Full Court of the Federal Court opened the way for the creation of closed classes limited to those claimants who also enter into a litigation funding agreement,[11] thereby neutralising the problem of so-called unfunded *"free riders"*.

For obvious reasons, banks and other large financial institutions are not intuitively attracted to providing litigation funding, at least for large retail investor class actions. Apart from the inherent uncertainties of litigation and risks of return, in broad terms they would effectively be funding claims against defendants on their own side of the fence.

Accordingly, litigation funding has tended to develop in the alternative finance markets.

Currently, there are about a dozen recognised litigation funders in Australia, the largest of which is currently IMF Bentham Limited, which is listed on the Australian Stock Exchange. According to recent publications, over the past 16 years it has successfully recovered about $2.1 billion (over 90% success rate), out of which over $1.3 billion was returned to claimants. IMF's current portfolio represents claims of about $3.7 billion across a range of

[10] *Campbells Cash and Carry Pty Ltd v Fostif Pty Ltd* (2006) 229 CLR 386
[11] *Multiplex Funds Management Ltd v P Dawson Nominees Pty Ltd* (2007) 164 FCR 275

disciplines and jurisdictions. With one or two exceptions, most other funders are presently unlisted and rely for their capital upon a mixture of private equity and debt.

Additionally, there are several law firms which are prepared to conduct class actions on a "no win; no fee" basis; eg., Slater & Gordon, Maurice Blackburn and Shine Lawyers; sometimes structured in combination with third-party funding, on a case-by-case basis. In passing, it may be noted that both Slater & Gordon and Shine Lawyers are listed on the ASX, whereas Maurice Blackburn is not.

Litigation funding arrangements invariably take the form of a private contract between the funder and the group members, and are thus enforceable in accordance with their terms. Typically, the litigation funding agreement will provide for the funder to receive a stepped proportion of the gross damages award (assuming success), ranging from about 30% to 45% depending upon the stage of proceedings, plus full recovery of all legal costs and expenses and any ATE insurance premiums. If the class action proceeds to judgment, then subject to any further order of the Court (which I will come to shortly), that is what usually occurs.

Experience shows that many major investor class actions do not proceed to judgment by the Court. More commonly, they are settled by mediation before trial.

One can infer that this occurs because class actions of this kind usually have good prospects of success upon objectively irrefutable evidence (eg., the defendant's own books and records, or the non-existence of requisite documents). Indeed, unless that were to be so it would not have secured funding; hence the notion that access to litigation funding operates as a “gateway” to filter out unmeritorious claims.

In passing it may be observed that the well-advised defendant must often, at a relatively early stage, have gained a pragmatic appreciation of its adverse defence prospects; but nevertheless, may feel compelled to battle on to a position of best advantage, so as to achieve settlement on terms reasonably palatable to its insurers and their underwriters and, one sometimes apprehends, so that management and their legal teams may gracefully disengage with their professional dignity intact.

In Australia, any settlement or discontinuance of a class action is subject to the approval of the Court. If the Court gives such an approval, it may make such orders as are just with respect to the distribution of any money paid under the proposed settlement.[12]

Unsurprisingly (at least in this jurisdiction), the Courts have never hesitated to exert their considerable supervisory powers[13] when scrutinising for approval the terms of any class action settlements, so as to ensure so far as reasonably possible that the claimants are not thereby unfairly prejudiced.

Relevantly in this context, several recent decisions demonstrate that the Courts are increasingly prepared to exercise their settlement approval powers in a manner that can have the effect of reshaping the balance of net distributions between the litigation funder and the claimants, and even as between different kinds of claimants.

In *Money Max v QBE*[14] the applicant had commenced a shareholder class action against QBE on behalf an open class comprising all persons who had acquired QBE shares in a certain period and had suffered losses by reason of QBE's alleged contraventions of the *Corporations Act*. However, only some of the class (1,290 shareholders) had entered into a litigation funding agreement with the funder.

The applicant applied for what is now known as a *"common fund order"* which would have had the effect of applying the terms of the funding agreement to all class members (with a reduced commission rate of 30%) so that all members, including those who had not entered into a funding agreement, would be obliged to contribute equally to the legal and litigation funding costs of the proceeding.

The respondent, QBE, opposed the application on the basis that a *"common fund order"* was not within the power of the Court, and that in any event a *"funding equalisation order"* was more appropriate. Such an order would allow deductions from the settlement amounts payable to the unfunded class members of amounts equivalent to the funding commission that would otherwise have been payable by them had they entered into a funding agreement. Such amounts would then be distributed pro rata across all class members, so

[12] eg., *Federal Court of Australia Act 1976*, s33V
[13] eg., *Federal Court of Australia Act 1976*, s23, s33ZF
[14] *Money Max Int Pty Ltd v QBE Insurance Group* (2016) 245 FCR 191

that both funded and unfunded class members would receive the same proportion of their settlement or judgment.

The Full Court of the Federal Court was satisfied both that it was empowered to make a *"common fund order"* and that such an order, subject to certain modifications by the Court, was appropriate.

In essence, the Court determined that its supervisory powers of approval of any settlement or judgment included making orders conditional upon the receipt of undertakings by the relevant parties, including the funder, to be bound by litigation funding terms considered to be appropriate by the Court.

The Full Court expressed the expectation that the Courts will approve funding commission rates that avoid excessive or disproportionate charges to class members but which recognise the important role of litigation funding in providing access to justice, are commercially realistic and properly reflect the costs and risks taken by the funder, and which avoids hindsight bias. Whether a funding equalisation order, a common fund order or some other order directed to equality of treatment is appropriate will depend upon the circumstances of the case and the position taken by its parties.

The application of these principles was recently demonstrated in *Blairgowrie Trading v Allco Finance Group*,[15] where Beach J framed the central question as whether the proposed settlement is fair and reasonable and in the interests of the group members bound by the settlement, considered as a whole.

His Honour went on to state that, in relation to the fairness of settlement as between group members, it must be ensured that the interests of the representative party, the funded group members, and any litigation funder are not being preferred over the interests of other group members, absent strong and compelling reasons for any such preferential treatment.

As to whether a court should set a commission rate and the rate that should be set, this is a largely forensic question depending upon the material available to the judge at the time the order is sought. It is not to be determined by some value laden proposition clothed in

[15] *Blairgowrie Trading Ltd v Allco Finance Group Ltd* (2017) 343 ALR 476 (Beach J)

language that it is not a suitable issue for the exercise of judicial power. Rather, the question to be determined is whether, in a particular case, a judge is in a position to, or should, set a rate by the application of the appropriate judicial method tailored to the circumstances of the individual case.

Another issue that has *yet* to be addressed by the Courts arises out of the fact that, although the listed and unlisted funding models for litigation funding with their various combinations of equity and debt, as earlier described, are reasonably functional, they are not entirely without difficulty.

In particular, from a cash flow perspective, class actions are notoriously unpredictable. The funder must endure a substantial cash burn for several years on the long-term prospect of achieving a cash return upon a successful settlement or judgment in favour of the claimants. That can present difficulties for companies that must meanwhile service the dividend expectations of shareholders and/or interest payments on finance facilities or debt or quasi-debt instruments. These cash-flow pressures have the potential to create significant conflicts between the short-term interests of the funder and its stakeholders, on the one hand, and the economic interests of the claimants, on the other - especially in the context of negotiating any settlement prior to hearing.

How these conflicts will be addressed by the Courts has yet to emerge. But in all events, one can safely anticipate that the Courts will exercise their considerable supervisory powers in a manner so as to ensure, so far as practicable, that the interests of the class members are not unfairly prejudiced. In this context, litigation funders would do well to recognise that their interests do not directly come into the equation.

Pleadings

To properly prepare pleadings for a financial services class action that are adequately comprehensive, with clarity and precision, is not an easy task.

- group member definition
- multiplicity of causes of action
- multiplicity of transactions over extended periods
- multiplicity of defendants - eg., changing of directors, auditors etc

In years past, the originating pleadings tended to be over-engineered and over-particularised, which was an approach that came to be trenchantly criticised by the Courts. A salutary example of the perils of this approach may be found in the MFS litigation which commenced in 2009 (and, I may add, eventually settled for the claimants on favourable terms in 2016)[16], in which the docket judge even went so far as to weigh the pleadings at 3.5kg (and that was before any defence had been filed). Another more recent example is *Dillon v RBS Group*, wherein the pleadings were not finalised for well over two years after commencement in October 2014.[17]

Informed by the Court's mandate to reduce procedural inefficiencies and the attendant time and costs, nowadays a more streamlined approach is actively encouraged, whereby the originating pleadings and particulars are tightly drawn at a relatively high level of generality. The level of detail is enhanced thereafter as required by interlocutory processes, occasionally on a collaborative basis by an exchange of correspondence but more usually on the application of the disgruntled defendant(s).

For example, in a class action that I am aware will be commenced within the next week or so, the statement of claim comprises about 20 pages only, in respect of claims for several hundred million dollars by many thousands of claimants. Of course, one may reasonably anticipate that the inevitable request for particulars will be as long or longer, but at least that process will facilitate an enlightened focus upon what are likely to be the real issues in dispute and inform the appropriate scope for the discovery of documents.

Split (or bi-furcated) trials & the determination of common issues

The general rule is that all issues of fact and law in a proceeding should be determined at one time, and that a party seeking a departure from the general rule should demonstrate that it is just and convenient for that course to be adopted. A recent and useful summary of the orthodox principles and underlying policy considerations can be found in the judgment of White J in *Prescott Securities v Gobbett*.[18]

[16] *Mercedes Holdings v Waters* (No 2) (2010) 186 FCR 450; (No 3) [2011] FCA 236; (No 5) [2011] FCA 1428 (Perram J)
[17] *Dillon v RBS Group (Australia) Pty Ltd* [2017] FCA 896 at [9]
[18] *Prescott Securities Limited v Gobbett (No 2)* [2017] FCA 81 at [13]

However, for practical reasons the established common practice in relation to large, complex class actions is quite different - that is, the Courts will almost invariably make orders for there to be a hearing of the so-called *"common questions"* which generally go to liability and the loss and damage of the representative party , separately and in advance of the determination of all other issues, which will broadly encompass issues of causation and quantum concerning the loss and damage of all other group members.[19] This approach is expressly reflected in the Federal Court's *Class Actions Practice Note*[20].

The powers of the Court to make these orders, commonly referred to as the *"Merck Orders"*[21] are found in FCA s33ZF and s37P. And as was recently explained by Lee J in *Dillon v RBS Group*,[22] the reason why Merck orders work (being in mind the Courts traditional aversion to interim or interlocutory declarations) is that they quell aspects of the overall justiciable controversy by reason of the keystone provision of Part IVA, s33ZB, which provides that the orders made at the conclusion of an initial trial will bind all group members (other than any person who has opted out) by what the High Court has described as a *"kind of statutory estoppel"*[23].

Dillon also provides a current example of the Court's practical and flexible use of its extensive case management powers in other ways; when confronted with a factual sub-stratum concerning a body of class members that differed from the applicant's pleaded case, the Court, in lieu of a further amended pleading and the formal joinder of additional representative applicants, ordered the applicant to procure a *"sample group member"* and to file and serve *"points of claim"* referable to the pleaded allegations but supplemented with the individual factual and legal contentions made by the sample group member.

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[19] *Johnson Tiles Pty Ltd v Esso Australia Pty Ltd (No 3)* [2001] VSC 372, at [80]; *Johnson Tiles Pty Ltd v Esso Australia Pty Ltd* [2003] VSC 27 at [42]; *Andrews & Ors v Australia and New Zealand Banking Group Ltd* (2011) 281 ALR 113 at [71]-[72]; *Matthews v SPI Electricity Pty Ltd* [2012] VSC 66 at [4]; *Rodriguez & Sons Pty Ltd v Queensland Bulk Water Supply Authority t/as Seqwater (No 5)* [2015] NSWSC 1771 at 16], [20]
[20] Federal Court of Australia, *Class Actions Practice Note (GPN-CA)* dated 25 October 2016, part 12
[21] *Merck Sharp & Dohme (Australia) Pty Ltd v Peterson* [2009] FCAFC 26
[22] *Dillon v RBS Group (Australia) Pty Lt*d [2017] FCA 896 at [66]
[23] *Timbercorp Finance Pty Ltd (in liquidation) v Collins* (2016) 91 ALJR 37 at 47 [52].

Even more recently (ie., within the past couple of weeks) upon becoming cognisant that three major class actions were proceeding against the same defendant upon substantially the same allegations, albeit in respect of different debenture schemes, the Court (Lee J) has asked for submissions as to why the several proceedings ought not to be brought under the same docket judge to be case managed together and heard concurrently at an initial trial of the common issues and other issues of commonality. The Court's motivation appears to derive not only from the potential savings in time and cost for the parties and the efficient use of Court resources, but also a firm desire to ensure comity in coincident or overlapping findings of fact and law at trial.

Not all practitioners, at least of orthodox experience, may welcome the rapid evolution of these flexible and practical procedures for the Courts to deal with large class actions; but there is much to commend the facilitation of efficient and cost-effective access to justice for a great number of consumer claimants, that would otherwise be denied.

End.