THE SHAREHOLDER

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FEDERAL GOVERNMENT ANNOUNCES INTENTION TO REVERSE SONS OF GWALIA

The Federal Government announced on 19 January 2010 its intention to pass legislation overturning the High Court of Australia's judgment in the *Sons of Gwalia* case in 2007. This announcement was made as part of its proposed Corporate Insolvency Law Reform Package.

The Government's move in this regard is contrary to advice received from the Corporations and Markets Advisory Committee ("CAMAC"), whom it had previously commissioned to report on the *Sons of Gwalia* decision and its implications.

In summary, the High Court in *Sons of Gwalia v Margaretic* determined that in a corporate winding-up, claims for compensation by shareholders who could prove they had been misled or deceived by the company were not subordinated to the claims of other unsecured creditors of the company. Instead, the Court held that a claim by a shareholder for the loss to the value of shares it held caused by the company's deception or failure to inform the market ranked equally with the claims of other unsecured creditors.

The crux of the High Court's decision was that Luka Margaretic, a shareholder whose test case had been funded by IMF, was not making his claim in his "capacity as a member of the company". Rather, Margaretic suffered damage at a point where he was a consumer and before he became a shareholder and it was in fact the perpetration of the relevant misconduct by the company which caused his loss.

The Corporations Act stipulates that only a claim made by a member of a company in his capacity as a member (i.e. a shareholder) is postponed until debts owed to, or claims made by, persons otherwise than as members of the company had been satisfied.

The decision by the Government to overturn the Sons of Gwalia decision is viewed by many as stripping shareholders of important rights to the detriment of Australia's market protection regime.

CAMAC in its report supporting the retention of the Sons of Gwalia decision, stated:

"Any move to curtail the rights of recourse of aggrieved shareholders where a company is financially distressed could be seen as undermining legislative initiatives to provide shareholders with direct rights of action in respect of corporate misconduct.

In effect, the facilitation of private remedies has added to the enforcement armoury, encouraging self-help by affected parties to complement the role of the regulators in relation to corporate disclosures. Shareholders and creditors share an interest in the promotion of an efficient and informed market."

Nevertheless, the Government in its recent announcement expressed various concerns in relation to the Sons of Gwalia decision. For example, it stated that the decision could undermine the distinction between debt and equity, lead to an increase in uncertainty in the conduct of external administration (and increase costs) and also potentially negatively impact on business rescue procedures.

IMF has previously argued against overturning the decision in a submission to CAMAC. IMF argued that to subordinate defrauded shareholders' claims against companies under external control would undermine our market protection laws and the reason for their design, namely to enhance corporate behaviour and the efficient allocation of capital. It was further submitted by IMF that the contention that the decision would result in the rising cost of debt was unfounded. This submission was supported by the UK experience, where a regime similar to that given effect by the Sons of Gwalia decision, operates.

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FEDERAL GOVERNMENT ANNOUNCES INTENTION TO REVERSE SONS OF GWALIA (CONTINUED)

The timing of the Government's proposed legislation is presently unknown, however if it is in fact implemented (which is not certain at this stage), it is highly unlikely to operate retrospectively. As a result, any claims by aggrieved shareholders in proceedings commenced prior to the legislation becoming effective will be determined on the basis of the *Sons of Gwalia* decision and the admitted claims of shareholders in those cases will rank equally with other unsecured creditors.

In response to these proposed amendments, IMF believes that certain important counter-balancing reforms aimed at strengthening the continuous disclosure regime should be considered, including:

- Amendment to the Corporations Act to provide a clear statement of what is required from shareholders to prove causally connected loss and how such loss is to be quantified; and
- Court Rule reform to require disclosure by insurers of relevant insurance policies providing cover to proposed defendants at the commencement of proceedings.

Further detail of these proposed reforms are set out below.

PROPOSED CORPORATIONS ACT REFORM - CAUSATION AND QUANTIFICATION

Security class actions in Australia currently take about 3 to 4 years to get to a trial and cost each side about $10 million.

This is undoubtedly the major cause of security class actions rarely being filed, let alone run to trial. There has not been one judgment despite the Market Protection Regime being with us for over a decade.

Two areas of Corporations Act reform that would go a long way to alleviate this concern, promote access to justice and the underlying policy of the Market Protection Regime, focus upon creating efficiencies in proving causation and quantifying loss.

The Aristocrat Judgment, and when that case settled, the AWB Judgment were expected to provide this direction. Now that AWB has settled (see further below), these issues will not now be determined authoritatively by the High Court within the next three or four years.

IMF considers that the Corporations Act ought to be amended to clarify the law on causation and quantification of losses on the basis that:

- sufficient proof of causal connection between a contravention and loss is proving that the price paid for the shares was greater than would have likely been paid but for the contravention; and
- the quantification of the loss, based on this level of proof, is the difference between the price paid and the price that would have likely been paid but for the contravention.

Individual shareholders may wish to prove that they would not have purchased the shares had they been aware of the information not disclosed or misrepresented. If this is proven, then loss caused by the contravention ought to be legislatively stated to be the amount which will put the shareholder in the position that the shareholder would have been in had the shareholder not purchased the shares.

PROPOSED RULE REFORM—DISCLOSURE OF FUNDING/INSURANCE ARRANGEMENTS

Some of the recent decisions relating to claimants' attempts to access defendants' insurance policies were discussed in the September 2009 edition of The Shareholder.

More recently, in *Snelgrove v Great Southern Managers Australia Ltd (In Liq) (Receiver and Manager Appointed)* [2010] WASC 51, Justice Le Miere in the Supreme Court of Western Australia made an order under s247A of the Corporations Act authorising the plaintiffs to inspect all insurance policies held by the defendant, the responsible entity of the managed investment scheme.

Notwithstanding this decision, applications seeking access to a defendants' insurance policy or policies are routinely resisted by defendants. This is an impediment to the Courts' stated objectives, being the just, quick and cheap resolution of matters before the Courts.

IMF has recently written to the Chief Justices of the Federal Court and each of the state Supreme Courts suggesting that the following amendments to the Court Rules be considered:

- Litigation funders, including insurers, ought to owe a duty to the court to seek to resolve claims according to law and as quickly, inexpensively and efficiently as possible; and
- Arrangements between any party to a civil proceeding and a third party providing financial assistance in respect of the proceeding (including insurance arrangements) be disclosed to the Court and the parties at the first return date.

FUNDED CLASS ACTIONS FOUND TO BE MANAGED INVESTMENTS SCHEMES

On 20 October 2009 the Full Court of the Federal Court in Victoria ruled by a majority of 2 to 1 that the Multiplex Part IVA proceeding is a managed investment scheme pursuant to the provisions of the Corporations Act,[1] overturning Justice Finklestein's decision at first instance.[2] IMF is not funding the Multiplex case but the decision has had implications for multiparty actions funded by IMF.

An application for special leave to appeal has been made to the High Court.

On 4 November 2009, ASIC announced that it would consider granting transitional relief to lawyers and litigation funders involved in legal proceedings structured as "class actions". The relief will apply until 30 June 2010 when it is anticipated that the Government will announce its intentions regarding the need and form of any regulation. As previously stated, IMF supports the regulation of litigation funding in Australia and the need for all litigation funders to be licensed under the Corporations Act (see further below).

On 5 February 2010, ASIC amended IMF's Australian Financial Services license, allowing IMF to issue interests in registered and unregistered managed investment schemes.

IMF has applied for transitional relief for all of its funded group and class actions. The majority of the actions have received the exemption, with decisions relating to three actions still pending.

IMF has applied for licensing as a Responsible Entity to allow IMF to operate any cases which do not receive an exemption from ASIC as Managed Investment Schemes once the schemes are registered under the Corporations Act.

1. *Brookfield Multiplex Ltd v International Litigation Funding Partners Pte Ltd* [2009] FCAFC 147.
2. *Brookfield Multiplex Limited v International Litigation Funding Partners Pte Ltd (No 3)* [2009] FCA 450.

COLLECTIVE REDRESS CONFERENCE

On 11 December 2009, various academics, legal practitioners and litigation funders, including IMF, gathered at the Sydney Law School to attend a conference entitled "Collective Redress and Litigation Funding".

The conference was convened by Dr George Barker, Director of the Centre for Law and Economics at the Australian National University.

The conference was attended by a number of eminent Australian and overseas academics and formed part of an international research and conference programme. The principal purpose was to share information on major developments in collective litigation (such as class actions) and litigation funding from around the world and to raise for discussion key issues confronting many jurisdictions.

Matters of particular interest arising at the conference included:

- Review of proposals by the European Union for collective redress but a rejection of the "American class action model" in favour of a diversity of approaches both at member state and EU levels.
- Review of the US class action landscape after the 1995 Private Securities Litigation Act and judicial trends toward limiting the scope of securities class actions in the United States.

AWB CASE SETTLES

On 15 February 2010 the class action IMF was funding against AWB Ltd settled, subject to court approval. Court approval to the settlement (which is a requirement of s33V of the Federal Court of Australia Act) will be sought on 23 April 2010.

In this case it was being alleged (among other things) that in the period March 2002 to January 2006 AWB had failed to disclose to the market that it had paid sums of money (over $200m) to the Iraqi Government, in the form of surcharges on sales of wheat, in breach of the UN Oil for food sanctions. AWB denied any misconduct.

This is the latest case to settle of a series of cases IMF has funded by persons who allegedly purchased shares in a listed company in a period at prices higher than they would have done so, had the misconduct not occurred. So far none of these cases has resulted in a Court decision and so key issues such as causation and loss calculation methodology, remain contentious and will do so until the High Court has spoken.

ADVERSE COSTS AND LITIGATION FUNDERS[1]

The issue of a litigation funder's liability to pay "adverse costs" (that is, the defendant's legal costs if the claimant is unsuccessful) is back on the agenda following a recent decision of the High Court of Australia. This is unlikely to affect clients of IMF as IMF typically agrees to meet any adverse costs risk as part of our funding service, but not all funders do so. Late last year the High Court had to decide whether it was an abuse of the court's process for a funder to refuse to pay adverse costs. The Court's decision has fuelled debate in Australia and the United Kingdom over the regulation of funders.

The High Court's Decision in *Jeffrey*

In October 2009, the High Court of Australia decided (by a 4-1 majority) that it was not an abuse of the court's process for a funder to finance litigation without also indemnifying the insolvent claimant against the risk of an adverse costs order if the claim was unsuccessful: *Jeffrey & Katauskas Pty Ltd v SST Consulting Pty Ltd* .[2]

The decision turned on the rules of the New South Wales Supreme Court. These state that a costs order could only be made against a third party, such as a funder, who had committed an abuse of the court's process. The High Court found that no abuse had occurred. As a result, the funder was not liable to pay the defendant's outstanding costs even though the defendant had won in both the Supreme Court and on appeal and the funder had already paid out on two orders for security for costs.

Although the High Court had decided in 2006 in *Fostif*[3] that litigation funding for reward is not an abuse of the court's process, the funder in *Fostif* had contractually agreed to pay any adverse costs.[4] The *Jeffrey* decision raised the prospect, in the words of one commentator, of funders being "allowed to gamble on litigation where they stood to reap substantial benefits but without the risks, as they were shielded from paying the adverse costs order of the impecunious plaintiff."[5] However, as in *Fostif* itself, Justice Heydon registered a strong dissent to the majority judgment.

The United Kingdom Position

In his review of UK civil litigation costs (published on 14 January 2010), Lord Justice Jackson expressed his support for litigation funding as a means of promoting access to justice. However, he concluded that the current UK rule in *Arkin*[6], under which a funder's liability for adverse costs is limited to "the extent of the funding provided,"[7] was unsound: "it is wrong in principle that a litigation funder, which stands to recover a share of damages in the event of success, should be able to escape part of the liability for costs in the event of defeat."[8] Jackson LJ recommended that "either by rule change or by legislation third party funders should be exposed to liability for adverse costs in respect of the litigation they fund"[9] with the extent of that liability being in the discretion of the court.

This recommendation was not surprising – UK funders may have been comforted by the rule in *Arkin* but, as Jackson LJ noted in his report, the facts of that case were unusual[10] and there was no guarantee that the courts would apply the decision in the future. UK funders usually ensure that adverse costs are adequately covered by insurance. In Australia, generally the court has the power to award costs against a funder and is likely to do so where the funded claimant is a man of straw",[11] although as the *Jeffrey* case demonstrates a court may not always be able to do so.

Regulation for Funders

With the issue of regulation for funders now firmly on the agenda in both Australia[12] and the UK, it is likely that the position espoused by Jackson LJ will prevail over that of the majority of the High Court.

In Australia litigation funders invariably agree to cover adverse costs incurred while the funding is in place, and any security for those costs, for the simple reason that claimants are reluctant to sign funding agreements without such protection. This practice may become a regulatory requirement, either through legislation, tougher licencing or new court rules.

A committee of judges, acting under the auspices of the Council of Chief Justices of Australia and New Zealand, is presently considering harmonised rules of court which would include a power to order that costs be paid by a funder and to provide for security for costs orders against funders.[13] ASIC and the Commonwealth Government are also considering regulatory issues affecting funded class actions in Australia as a result of the Full Court's decision in *Brookfield Multiplex Ltd v International Litigation Funding Partners Pte Ltd*.[14] Enhanced regulation of Australian funders is likely to emerge from that process.

IMF's submission to the Treasury Class Actions Roundtable on 10 March 2010, addressing a number of matters, including regulation of litigation funding can be found on IMF's website http://www.imf.com.au/regulation.asp

Liability to meet adverse costs raises the equally important issue of a funder's on-going *ability* to do so. Jackson LJ, "after some hesitation", favoured regulating UK funders under a Voluntary Code of Conduct being developed by the Civil Justice Council provided there is a "substantial tightening up" of the capital adequacy provisions of the draft Code.[15] IMF's Wayne Attrill has been appointed to the interim body responsible for finalising the Code.

In Australia, the Standing Committee of Attorneys-General in its May 2006 Discussion Paper on litigation funding asked whether litigation funders should be subject to prudential regulation.[16] In response, the Law Council of Australia submitted that all funders should be required to obtain an Australian Financial Services Licence ("AFSL") and be subject to supervision by ASIC.[17] IMF (Australia) Ltd is the only Australian funder with an AFSL.[18] If regulation of funders emerges in Australia this year, all funders

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ADVERSE COSTS AND LITIGATION FUNDERS (continued)

may be required to hold an AFSL which will subject them to appropriate prudential supervision. This will go a long way to ensuring that funders will be able to meet any adverse costs incurred in litigation they fund. IMF would welcome this development.

1. This article is an abridged version of a longer piece appearing in the latest Litigation Funding magazine.
2. [2009] HCA 43 ("*Jeffrey*").
3. *Campbells Cash and Carry Pty Ltd v Fostif Pty Ltd* [2006] HCA 41; (2006) 229 CLR 386 ("*Fostif*").
4. *Fostif*, [2006] HCA 41, [117]; (2006) 229 CLR 386, 441 per Kirby J.
5. M Legg, "Security for costs the solution for litigation funding", A*ustralian Financial Review*, 13 November 2009, p 42.
6. *Arkin v Borchard Lines Ltd* [2005] EWCA Civ 655 ("*Arkin*").
7. *Arkin* [41]
8. Rt Hon Jackson LJ, *Review of Civil Litigation Costs: Final Report* (December 2009), Chapter 11, [4.6].
9. Ibid, Chapter 11, [4.7].
10. The funder met only part of the costs of the litigation: Ibid, Chapter 11, [4.3].
11. In *Knight v FP Special Assets Ltd* [1992] HCA 28, [34], (1992) 174 CLR 178, 193 Mason CJ and Deane J opined that costs may be ordered against a non-party "where the party to the litigation is an insolvent person or man of straw, where the non-party has played an active part in the conduct of the litigation and where the non-party, or some person on whose behalf he or she is acting or by whom he or she has been appointed, has an interest in the subject of the litigation." See also *Dymocks Franchise Systems (NSW) Pty Ltd v Todd* [2004] UKPC 39, *Gore v Justice Corporation Pty Limited* [2002] FCA 354 and Mason P in the New South Wales Court of Appeal in *Fostif*: "Defendants . . . may obtain special costs orders against funders if the proceedings fail": *Fostif Pty Limited v Campbells Cash and Carry Pty Limited* [2005] NSWCA 83 at [120].
12. The Standing Committee of Attorneys-General (comprising the Attorney's-General for the Australian Commonwealth, states and territories and of New Zealand) ("**SCAG**"), which has been considering the regulation of litigation funders since 2005, announced in November 2009 that "the Commonwealth Minister for Financial Services, Superannuation and Corporate Law will build upon the work already done by SCAG on the regulation of litigation funding by considering the extent to which litigation funders should be regulated by the Australian Securities and Investments Commission (**ASIC**)."
13. The Hon Justice Kevin Lindgren, "*Some Current Practical Issues in Class Action Litigation"*, (2009) 15(2) UNSWLJ Forum 17-18.
14. [2009] FCAFC 147. The Full Court held by a majority that the funded class action in that case was a "managed investment scheme" which required either registration with, or exemption by, ASIC to proceed. ASIC subsequently granted a transitional exemption to this and other pending class actions.
15. Rt Hon Jackson LJ, *Review of Civil Litigation Costs: Final Report* (December 2009), Chapter 11, [3.4].
16. SCAG, Litigation Funding in Australia, Discussion Paper, May 2006 p 12.
17. Law Council of Australia, Litigation Funding, 14 September 2006, [87].
18. One other funder has been granted an exemption from holding an AFSL by ASIC.

CLASS ACTION REVIEW

In December 2009, the first report of a major empirical study of Australia's class action regime, conducted by Professor Vince Morabito of Monash University was released. The study was funded by a number of parties including IMF.

The aim of the ongoing study is to assess whether the Federal Court and Victorian Supreme Court regimes[1] which regulate class actions are achieving the stated objectives of access to justice and an efficient and effective means to resolve multiple claims. The Federal Court of Australia and the Victorian Supreme Court are the only superior courts in Australia where "US-style" class actions may be filed.

The Report provides some interesting insights about class actions and, relevantly, shareholder class actions.

The Report reveals that actions brought on behalf of investors and shareholders have risen since the commencement of the Federal Court Regime. These claims now represent 25% of the 56 Part IVA "class actions" filed in the Federal Court from July 2004.

However, the common suggestion often seen in press reports that class actions are "exploding" is far from the truth. Class actions represent less than 1 per cent of all cases filed in the Federal Court.

Maurice Blackburn ('MB') and Slater & Gordon ('S&G') are the only firms to have been involved in at least 10 Part IVA proceedings.

The average time it took for Part IVA proceedings to finalise was 23 months. The most frequent outcome of Part IVA proceedings is settlement.

Since September 2000, 52.6% of matters have settled, an increase from 28.8% in the period from March 1992 to September 2000. It was found that settlement is more likely if the proceedings were filed in the Victorian Registry and if the litigation is conducted by MB or S&G.

The further outcomes of the study, such as the extent to which parties to class action proceedings have been engaged in interlocutory warfare and the operation of the "opt-out" regimes are awaited with interest. The Study will ensure that the Commonwealth Attorney General's Access to Justice Taskforce and debate as to the reform of the class action regimes will be undertaken using objective data.

1. The regime regulating class actions in the Federal Court of Australia is found in Part IVA of the *Federal Court of Australia Act 1976* (Cth) and the regime regulating actions in the Supreme Court of Victoria is Part 4A of the *Supreme Court Act 1986* (Vic).

2. There is in fact no concept of a "class action" in Australia. The term is used loosely to define the different types of multi-party actions that exist in Australia and which comprise (1) a representative action under part IVA of the Federal Court Act or under the rules of the various State Supreme Courts (2) a group action (3) a test case where the parties and the Court accept that the resolution of that case will govern the out come of all of the others.

NEW ZEALAND GIVES THE "GREEN LIGHT" TO LITIGATION FUNDING

The High Court of New Zealand in an interlocutory judgment in the landmark "Feltex Carpets" case has dismissed an application by the defendants to stay the proceeding as an abuse of process on the grounds of champerty (meaning that the plaintiffs' action was being maintained by a third party funder).

The case was commenced as a representative action on behalf of shareholders of the failed Feltex Carpets Ltd against the company's directors and promoters. The shareholders who sought to recover loss and damage were those that purchased shares in the IPO of Feltex and those who purchased its shares on market prior to its demise in September 2006.

The defendants' application to stay the case included an argument that the funding arrangements entered into by the plaintiffs were champertous. In summary, the Court of Appeal dismissed this application and concluded that such funding did not comprise an abuse of process.

The Court noted that in more recent years there has been a dramatic change in judicial attitude towards maintenance and champerty, with some jurisdictions abolishing the tort of champerty altogether and courts generally adopting a much more liberal and relaxed approach.

The Court further noted that in an age where the costs of litigation are beyond the means of many, professional funders have an increasingly important role to play in ensuring that legal obligations and rights are enforced and vindicated. It relied heavily on the High Court of Australia's 2006 *Fostif* decision, noting that the principles and policy considerations articulated in that case were of sufficient general application to be able to be relied upon.

In concluding, the Court noted it was highly likely that claims of the type brought in this proceeding would become increasingly common in New Zealand and its Courts must be ready to accommodate them as best they could. IMF funded its first case in New Zealand last year.

CLASS ACTION PROPOSED AGAINST TRANSPACIFIC INDUSTRIES LIMITED

On 8 March 2010 IMF announced that it proposed to fund claims against Transpacific Industries Group Ltd ("TPI") by certain current and former shareholders.

What was particularly different about this announcement was that due to the current position with respect to Registered Managed Investment Schemes ("MIS"), and the rejection by ASIC of an application by IMF for an exemption, the class of shareholders would be further limited to sophisticated and professional investors ("SPI") only. In limiting the class to SPI, IMF, through recent amendments to its Australian Financial Services Licence, is entitled to run an unregistered MIS. Unfortunately therefore, whilst the various provisions of the Corporations Act are designed to protect retail investors, they have, in this instance, prevented retail investors from enforcing their rights by means of joining the IMF group action.

If at some stage in the future the position in relation to MIS changes, or an exemption is granted to IMF by ASIC, then IMF will apply to the court to reopen the class to enable retail investors to join.

The proceedings will be open to SPI who purchased TPI shares during the period 28 February 2008 to 16 February 2009. The proceedings will claim that TPI failed to fulfil its disclosure obligations in relation to :

1. Its reported earnings for FY08 (which were restated in July 2009); and
2. Its forecasted earnings for both FY08 and FY09.

NEWS IN BRIEF

IMF's HALF YEAR RESULTS ANNOUNCED 25 FEBRUARY 2010

Investor presentation can be viewed via the following link: www.imf.com.au/announcements

A LIST OF FUNDED MULTI-PARTY SHAREHOLDER ACTIONS AND PROPOSED ACTIONS CAN BE VIEWED AT: www.imf.com.au/cases

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