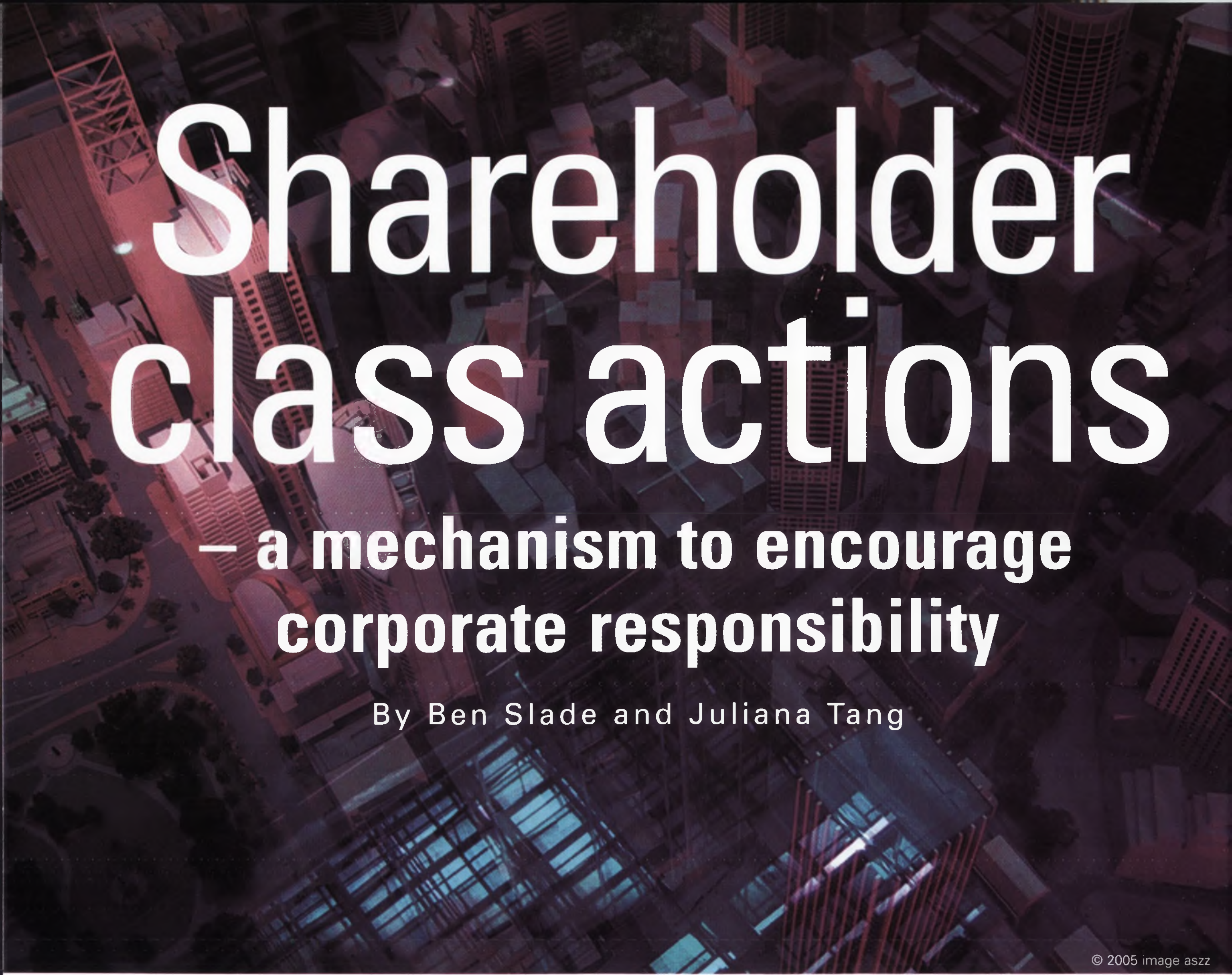

Shareholder class actions

– a mechanism to encourage corporate responsibility

By Ben Slade and Juliana Tang

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Class actions in Australia and the US have typically pursued mass tort claims in product liability and personal injury. However, in a context of complex corporate wrongdoing and resource constraints upon regulatory bodies, the investor class action is emerging as a private mechanism for enforcing good corporate governance and corporate responsibility.

A class action is an action where a person represents him or herself on behalf of six or more others with the same or similar claims against a common defendant or defendants. Class actions, or 'representative proceedings', have been available since 1992 in the Federal Court of Australia, and since 2000 in the Supreme Court of Victoria (see Part IVA of the *Federal Court of Australia Act* 1976 (Cth) and Part IVA of the *Supreme Court Act* 1986 (Vic)). Class actions through a facilitated opt-out procedure are not available elsewhere in Australia,[1] although a number of statutory provisions, such as s88 of the *Anti-Discrimination Act* 1977 (NSW), provide for opt-in representative procedures.

The Supreme Court Rules in each state and territory provide for representative proceedings where a person commences an action on behalf of a number of people with the same interest. There are no details in the Rules about how a representative proceeding is to be conducted and, to date, very little judicial guidance has been given.[2]

FOUNDATION OF A SHAREHOLDER CLASS ACTION

Shareholder class actions are, not surprisingly, based on laws designed to ensure proper corporate conduct and provide protection to consumers and to the market. The shareholder class action is typically concerned with the actions or omissions of a company, its directors or officers that cause loss to shareholders. Losses suffered as a result of tortious conduct, misleading and deceptive conduct, fraud or market manipulation in breach of the *Corporations Act* 2001 (Cth), *Trade Practices Act* 1974 (Cth) (TPA), or *Australian Securities and Investment Commission Act* 2001 (Cth) (ASIC Act), are now being pursued through investor class actions.

Shareholder actions commonly include a claim for damages following a breach of one or more of the following:

- the misleading and deceptive conduct provisions in the *Corporations Act* (ss1041H and 1041I), the TPA (ss52 and 82), the ASIC Act (ss12DA and 12GF) and state and territory fair trading acts (FTA);
- the provisions in the *Corporations Act* concerning misstatements and omissions in prospectuses and other 'disclosure documents' that offer securities (ss728 and 729);
- the continuous disclosure provisions in the *Corporations Act* (Chapter 6A, s674(2)); and
- the common law duty of care (for negligent misstatement or negligent advice).

To recover damages for a breach of the misleading conduct provisions of the *Corporations Act*, the TPA, the ASIC Act, or an FTA, shareholders must prove that their losses were caused by the contravening conduct of the company, its directors or other officers. This may require proof that each shareholder not only relied on the alleged contravening conduct but was also thereby led into error. The relevant conduct must have been a cause of the loss; that is, the conduct must have materially contributed to the loss, but need not be the sole cause.[3]

Corporations Act s728

It is a breach of s728 of the *Corporations Act* for a person to offer securities under a disclosure document (that is, a prospectus, profile statement or an offer information statement) that contains a misleading or deceptive statement or an omission that is materially adverse to the investor. Investors who have suffered loss or damage by reason of that breach can recover compensation from various persons, including persons offering the securities or directors of the body offering the securities (s729).

An omission in a disclosure document is considered a breach of s728 if it fails to disclose matters set out in ss710 to 715 of the *Corporations Act*. Section 710 provides, among other things, that a prospectus offering shares must contain all the information that investors and their professional advisers would reasonably require to make an informed assessment of the rights and liabilities attached to the shares offered, and the assets and liabilities, financial position and performance, profits, losses and prospects of the body issuing the shares.

A contravention of s728 is not a contravention of the misleading and deceptive conduct provisions in the *Corporations Act* or ASIC Act (s1041H (3)(a)(ii) and s12DA(1A)(a)(ii)). But an investor still has the right to pursue a claim for misleading and deceptive conduct under s52 of the TPA.

Continuous disclosure

Another claim available to shareholders is one based on breach of the continuous disclosure provisions of the *Corporations Act*. Section 674(2) of the *Corporations Act* requires 'disclosing entities', including public companies, to notify the ASX in accordance with ASX Listing Rule 3.1, of any information not generally available which a reasonable person would expect, were it generally available, to have a material effect on the price or value of the company's shares.

In *ASIC v Southcorp (No 2)* (2003) 130 SCR 406, the first decision under the new civil penalty regime for contravention of the continuous disclosure provisions, Justice Lindgren recounted the legislative history of continuous disclosure provisions. His Honour referred to a statement in the Second Reading Speech of the Corporate Law Reform Bill (No 2) 1992 (Cth), that an effective disclosure system could be 'a significant inhibition on questionable corporate conduct. Knowledge that such conduct will be quickly exposed to the glare of publicity, as well as criticism by shareholders and the financial press makes it less likely to occur in the first place.'

The purpose of the continuous disclosure provisions, according to his Honour, was to 'prevent selective disclosure of market-sensitive information'.

In a claim for damages under the continuous disclosure provisions, it may not be necessary to prove 'reliance' in order to establish cause of loss. Arguably, if a shareholder acquired shares at a price above their true value on the ASX because they were not properly informed, owing to a failure to disclose, that would be sufficient to establish that they suffered loss.

In the US there is a presumption of reliance, which is based largely on the US Supreme Court's decision in *Basic v Levinson* [485 US 224 (1988)]; namely, that an investor's reliance on any public misrepresentation may be presumed because most publicly available information is reflected in the market price of the shares. This is yet to be tested in Australia.

Tort actions

Investors may also have rights in actions in tort to recover losses suffered as a result of share purchases made relying on negligent misstatements or negligent advice. To succeed in an action for negligent misstatement or negligent advice, an investor will need to prove that the representor or adviser owed a duty of care to the investor to ensure any representations made were true and reliable, that misrepresentations were made or careless advice was given in breach of that duty, and that the misrepresentation or advice induced the investor to acquire the shares, resulting in loss or damage.

DEFENDANTS IN A SHAREHOLDER CLASS ACTION

Wrongdoers facing shareholder class actions include companies in which investors have acquired an interest, directors or other officers involved in the contravening conduct, advisers (financial or otherwise) and experts named in a prospectus.

In actions for damages arising from breaches of the *Corporations Act*, the TPA and ASIC Act, investors have rights to claim damages against a person who directly engaged in the misconduct or against 'any person involved in the contravention'.[4] Where breaches of these federal laws are >>

alleged, it is commonly pleaded that the defendant company engaged in the contravening conduct as the principal offender, while individuals, such as directors or other officers, are alleged to be liable as accessories.

A 'person involved in a contravention' is defined in s75B of the TPA and s79 of the *Corporations Act* as a person who:

- has aided, abetted, counselled or procured the contravention;
- has induced, whether by threats or promises or otherwise, the contravention;
- has been in any way, directly or indirectly, knowingly concerned in, or party to, the contravention; or
- has conspired with others to effect the contravention.

To establish a defendant's accessorial liability under s75B, the principal's contravention must be proved, and actual knowledge of the essential elements or facts of the contravention must be proved against the accessory (*Yorke v Lucas* (1985) 61 ALR 307).

Further, in misleading and deceptive conduct claims concerning future matters, the onus of proof in a 'reasonable grounds' defence shifts. Whereas a defendant principal must prove 'reasonable grounds' under s51A(2) TPA, in an accessorial liability claim under s75B TPA,[5] the plaintiff must show that there were no 'reasonable grounds'.[6]

However, if a corporation is liable for conduct in breach of an FTA, officers or agents that act on behalf of that corporation are also liable under the same statute as the principal offender.[7] In these circumstances, pleading primary liability under an FTA against officers or agents of a corporation may circumvent the increased burden of proving evidence of accessorial liability under the equivalent provisions of the federal statutes.

Where misleading and deceptive statements are proved in disclosure documents, a wide range of persons may be liable for damages. Section 729 of the *Corporations Act* makes it clear that the following persons are liable for loss or damage arising from a breach of s728, even if they did not commit and were not involved in the breach:

- the person making the offer of securities;
- each director of the body making the offer of securities;
- a person named in the disclosure document with their consent as a proposed director of the body whose securities are being offered;
- an underwriter (not sub-underwriter) to the issue or sale named in the disclosure document with their consent;
- a person named in the disclosure document with their consent as having made a statement:
  (a) that is included in the disclosure document; or
  (b) on which the statement made in the disclosure document is based; and
- any person who contravenes, or is involved in the contravention of s728(1).

Section 729 also states that persons who make the securities offer, directors and proposed directors, and underwriters named in the prospectus with their consent, are liable for loss and damage suffered as a result of any breach of s728(1).

The wide ambit of those exposed to liability under s729 is offset by statutory defences. A 'due diligence' defence is available for prospectuses (s731); a 'lack of knowledge' defence is possible for offer information statements – profile statements can be called on (s732); and there are general defences in relation to all disclosure documents (s733).

In addition to claims for damages arising from the causes of action discussed above, directors and other officers are also personally exposed to pecuniary penalty orders (s1317G) and compensation orders (s1317H) for breaches of duty. These include the improper use of one's position as director or the office of the corporation for personal advantage, or to cause detriment to the corporation (ss182 and 184(2)); and improper use of information obtained in office, or when previously in office, for personal advantage or to cause detriment to the corporation (ss183 and 184(3)).

In May 2005 two papers by the Corporations and Markets Advisory Committee[8] prompted discussion of the duties and liabilities of directors and other officers. *Personal Liability for Corporate Fault* reviews the circumstances in which directors and corporate managers may be personally liable for corporate misconduct by virtue of positions held in the corporation, without the need to establish misconduct on their part ('derivative liability'). As personal liability in these circumstances may discourage people from accepting directorships or undertaking responsible corporate roles, the paper seeks to examine alternative derivative liability models to better achieve a balance between corporate compliance and the interests of corporate officers.

The second paper, *Corporate Duties Below Board Level*, reviews personal liabilities and duties under the *Corporations Act* to address gaps in the regulation of corporate behaviour below board level, as raised in the HIH Royal Commission report by the Commissioner, Justice Owen. Copies of both papers are available on the Advisory Committee's website at *www.camac.gov.au*.

SHAREHOLDER CLASS ACTIONS IN AUSTRALIA

Recent actions that have made a significant contribution to the development of shareholder class actions in Australia are:

- *King v GIO Australia Holdings Limited* [2003] FCA 980 (settled) (*GIO*);
- *Lukey v Corporate Investment Australia Funds Management Pty Ltd* [2005] FCA 298 (settled) (*TrackNet*);
- *Dorajay Pty Ltd v Aristocrat Leisure Limited* (currently in the Federal Court) (*Aristocrat*);
- *Harvey Digby Pty Ltd v Adam Clark & Ors* (currently in the Supreme Court of Victoria) (*Media World*); and
- *Cadence Asset Management Pty Ltd v Concept Sports Limited & Ors* (currently in the Federal Court) (*Concept Sports*).

GIO

In 1999 Shane King commenced Australia's largest ever shareholder class action. The claim against GIO, its directors, and its adviser, Grant

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Samuel & Associates Pty Ltd, concerned advice given to shareholders about whether or not to accept a hostile takeover offer by AMP. It was alleged that in December 1998 misleading and deceptive statements were made to shareholders that AMP's offer of $5.35 per GIO share was inadequate, that AMP's offer should be rejected, and that GIO would make a profit of $200 million in the 1998/1999 financial year.

On 30 June 1998, approximately six months after the $200 million profit-forecast, GIO announced a loss of $750 million, a deterioration of $1 billion. In December 1999, AMP acquired the remaining shares for $2.75 by compulsory acquisition.

Ninety-nine per cent of GIO shareholders were small shareholders, holding fewer than 5,000 shares each. Accordingly, they relied on the company and its directors to give them accurate and balanced advice. The shareholders claimed that they had accepted and relied on the advice given to them by the GIO Board and had thereby lost the opportunity to sell their shares for $5.35.

In August 2003, almost 23,000 shareholders were able to participate in the settlement of the claim. The case was settled once a list of 'Identified Group Members' could be created and individual and total losses calculated. The federal court approved a settlement of $97 million plus costs on 26 August 2003, making it the largest shareholder class action in Australian legal history.[9]

TrackNet

In December 2000, Samantha Lukey commenced a federal court class action in NSW on behalf of herself and 156 investors in the TrackNet Project. Investors relied on a prospectus that said the project had access to the necessary technology for a vehicle-tracking and communications system when there was, in fact, no technology available to it. Further, the Hong Kong company that allegedly owned the technology did not exist, and a licence agreement between it and the operator of the project, TrackNet Australia Pty Limited, was fabricated.

Proceedings were issued against the management company that issued the prospectus, Corporate Investment Australia Funds Management Pty Limited (CIAFM); three of its directors; the trustee, Cardinal Financial Securities Limited; and TrackNet, for losses arising from misleading or deceptive conduct in a prospectus, breach of trust and breach of contract.

A hearing on the preliminary issues of liability, causation and assessment of Ms Lukey's damage was heard before his Honour Justice Emmett in late 2003. In March 2004, his Honour published his provisional conclusions that CIAFM had published a prospectus that contained misleading and deceptive statements, and that Cardinal was guilty of breach of trust by allowing funds to be transferred to CIAFM without proof that expenditure-qualifying conditions had been met. However, he also found that neither Cardinal's inclusion in the prospectus nor statements made by the directors in the prospectus allowed a finding that Cardinal was liable, either directly or as an accessory to CIAFM's misleading publication of the prospectus.

Negotiations following the provisional conclusions resulted in a settlement in June 2004, approved by the Court, which returned $1.7 million to investors.[10]

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Third-party litigation funders add an additional layer of complexity to shareholder class actions.

Aristocrat

In November 2003, a class action was filed against poker-machine manufacturer and distributor, Aristocrat Leisure Limited (Aristocrat) on behalf of investors who acquired shares in Aristocrat between 20 September 2002 and 26 May 2003, and who at any time instruct the solicitors for the plaintiff, Dorajay Pty Limited.[11]

The claim alleges that Aristocrat engaged in misleading and deceptive conduct in making false and misleading profit forecasts and statements about the company's financial position, following various profit downgrade announcements that began on 20 September 2002, and by remaining silent. It is also alleged that Aristocrat failed to fully disclose material information to the market in a timely manner in breach of its continuous disclosure obligations under s674(2) of the *Corporations Act* and/or ASX Listing Rule 3.1.

It is also alleged that as a result of the contravention of the continuous disclosure obligations and the misleading and deceptive conduct, the claimants acquired, or continued to retain an interest in, shares in Aristocrat during the relevant period and, as a result, suffered loss.

Third-party litigation funders add an additional layer of complexity to shareholder class actions. In the case of the Aristocrat class action, a third-party is financing the costs of the Aristocrat class action in return for a proportion of the damages should the claim succeed, and all group members to the action must enter into an agreement covering that arrangement. The respondent believes that the involvement of the funder, to the extent that it is directing and controlling the litigation, amounts to an abuse of process. The issue of the funder's role in class actions was the basis of the respondent's strike out motion, heard before Justice Stone on 15 and 16 June 2005.[12]

Media World and Concept Sports

Over 100 shareholders in Media World Communications Limited (MWC) are claiming damages in the Supreme Court of Victoria caused by misleading representations made about the capabilities of the company's video compression technology. MWC went into administration on 22 September 2004 after internal testing demonstrated that the technology did not work as claimed.

An application by the Media World shareholders to be recognised as creditors was rejected in the federal court in *Crosbie, in the matter of Media World Communications Ltd (Administrator Appointed)* [2005] FCA 51. Justice Finkelstein held that shareholders who purchased by subscription could not recover damages against the company on the ground that they were induced to subscribe for those shares by fraud or misrepresentation unless they had first renounced their shareholding. He also held that a shareholder cannot rescind a shareholding once a company has entered administration or liquidation. This ruling gives a company in administration or liquidation a complete defence to a damages claim by subscription shareholders.

Justice Finkelstein's ruling has been challenged by the shareholders of Concept Sports Limited who are claiming damages for misleading statements in the prospectus, material omissions from the prospectus and a breach of the continuous disclosure regime of the Australian Stock Exchange.

CONCLUSION

Representative proceedings are designed to enhance the ability of a large number of people to gain compensation for losses, whether large or small. Notwithstanding the present paucity of jurisprudence, the class action appears well-adapted to situations where investors have suffered financially because of corporate malfeasance. Nevertheless, its use by shareholders will supplement, rather than supplant, public enforcement by regulatory authorities. ■

Notes: 1 In SA, Rule 34 of the Supreme Court Rules provides some guidance to the Court. **2** See *Fostif Pty Ltd v Campbells Cash & Carry Pty Ltd* [2005] NSWCA 83. **3** *I & L Securities Pty Ltd v HTW Valuers (Brisbane) Pty Ltd* [2002] HCA 41; *Henville v Walker* (2001) 182 ALR 37; *Gould v Vaggelas* (1985) 157 CLR 215. **4** See s1041I of the *Corporations Act*, s82 of the TPA, s12GF of the *ASIC Act*. **5** *ACCC v Universal Sports Challenge Pty Ltd* [2002] FCA 1276; *Quinlivan v ACCC* [2004] FCAFC 175. **6** *Quinlivan; Downey v Carlson Hotels Asia Pacific Pty Ltd* [2005] QCA 199 at [35]. **7** *Cleary v Australian Co-operative Foods Ltd* (1999) 32 ACSR 701 at [54]-[57]; *Arktos Pty Ltd v Idyllic Nominees Pty Ltd* [2004] FCAFC 119. **8** The Corporations and Markets Advisory Committee was established in September 1989 under Part 9 of the *ASIC Act*. **9** *King v GIO Australia Holdings Limited* [2003] FCA 980. **10** The judgment on a cross-claim provides a detailed analysis of the claim: *Lukey v Corporate Investment Australia Funds Management Pty Ltd* [2005] FCA 298. **11** See *Dorajay Pty Ltd v Aristocrat Leisure Limited* [2004] FCA 634 (20 May 2004). **12** At the time of publication a judgment has yet to be handed down.

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