SUPPLEMENTARY SUBMISSION TO THE AUSTRALIAN LAW REFORM COMMISSION

Inquiry into Class Action Proceedings and Third-Party Litigation Funders

October 2018

SUPPLEMENTARY SUBMISSION
TO THE AUSTRALIAN LAW REFORM COMMISSION

Inquiry into Class Action Proceedings and Third-Party Litigation Funders

October 2018

Maurice Blackburn Lawyers Since 1919

Having regard to the issues raised in some of the submissions to the inquiry as well as reformulated proposals that have been put forward by the ALRC, our supplementary submission addresses three of the areas being considered in the inquiry.

1. NO JUSTIFICATION FOR REVIEW OF CONTINUOUS DISCLOSURE LAWS

1.1 There are a number of consistent themes in the submissions of those who advocate a review of continuous disclosure laws, presumably with the ultimate objective of achieving legislative change to the effect that listed companies' disclosure obligations should be less onerous or that aggrieved investors should not be able to vindicate their rights. Many of these themes are misguided, wrong or unsupported by evidence.

1.2 The submissions are made by entities whose commercial interests lie in avoiding liability for failing to disclose material information to investors, despite the effect that this would have in denying redress to investors who have suffered significant losses by trading shares on an uninformed basis and despite the implications for market integrity more broadly. By contrast, the existing suite of continuous disclosure laws is supported by our companies and securities regulator[1] and by institutional shareholders and fund managers who made submissions to the inquiry.[2] In addition the ASX has itself noted the "critical importance of timely disclosure of market sensitive information to the integrity and efficiency of the market".[3]

1.3 Our supplementary submission addresses a number of the themes raised in the submissions of entities who seem to favour an environment where there should be less disclosure to investors and/or less redress for those who have been misled. We remain strongly of the view that there should be no review of our existing continuous disclosure laws or their economic or legal impact.

Prevalence of shareholder class actions

1.4 Several submissions asserted that companies "face a real threat of securities class actions *whenever* there is a significant shift in the company's share price".[4] This, frankly, is an alarmist myth that has no empirical basis.

1.5 In the last 12 months, among the 500 companies in the ASX All Ordinaries Index (which represents approximately 22% of the 2,256[5] ASX listed companies), there were more than 2,600 instances where a company's share price fell by more than 5%,[6] and yet only a tiny number of those share price falls resulted in a shareholder class action – that number is measured in single digits, as far as we are aware.

[1] Australian Securities and Investments Commission, *Submission 72*.
[2] AustralianSuper, *Submission 33*; Hesta, *Submission 61*; Bennelong Funds Management, *Submission 10*.
[3] ASX Listing Rules Guidance Note 8 at 61.
[4] Australian Institute of Company Directors, *Submission 35* at 2; see also Risk Management Society of Australasia, *Submission 59*.
[5] As at 28 September 2018; the complete list of companies on the ASX's Official List is available on the ASX website: https://www.asx.com.au/asx/research/listedCompanies.do.
[6] We selected 5% for the purpose of this analysis in light of the rules of thumb for materiality as set out in ASX Listing Rules Guidance Note 8 at 61-2.

1.6 The submissions of the Australian Institute of Company Directors and others overlook the obvious fact that not every downward share price movement is actionable – only those that occur in circumstances where management was aware of material information (in the objective sense described below) and failed to disclose it to the market, with shares therefore trading on an uninformed basis until a corrective disclosure is made.

1.7 The adverse costs rule operates to safeguard against frivolous claims being brought solely on the basis of a downward share price movement in the absence of a reasonably arguable claim that material information was withheld from the market.

1.8 More broadly in relation to the prevalence of shareholder class actions, it is true that there has been an increase in more recent times, however the overall incidence remains low. In the 16.5 years since the introduction of the current continuous disclosure obligations in 2002, shareholders of only 55 ASX listed companies or groups[7] of companies have brought claims, and this includes claims brought only against directors or third parties such as auditors. This is an annual average of little more than three per year, in contrast to more than 1,500 ASX listed companies in 2002, which grew to more than 2,000 in 2007 and now stands at more than 2,200.[8] While it is true that shareholder actions are relatively more common now than they were a decade ago, it is wrong to suggest that shareholder claims are rampant or excessively prevalent or can be triggered by any significant reduction in a company's share price. The modest increase in the incidence of shareholder class actions is an unsurprising by-product of the practice of shareholder class actions evolving and becoming more established, and these types of actions also becoming a more widely accepted form of legal redress, particularly among institutional investors.

Fault element in liability for breach of continuous disclosure

1.9 Several of the responses to the ALRC's call for submissions refer to the level of fault which gives rise to an actionable breach of companies' continuous disclosure. The Australian Institute of Company Directors, for example, states that claims can succeed without proof of intention, recklessness or negligence, and can thus be "difficult to defend", notwithstanding that the company's directors may have acted honestly and reasonably.[9] The Risk and Insurance Management Society (**RIMS**) describes Australia's continuous disclosure obligations as imposing strict liability.[10]

1.10 These submissions mischaracterise the operation of the legal framework which imposes liability for continuous disclosure breaches.

1.11 A company only has an obligation to disclose material information once it has become "aware" (through the awareness of its officers) of that information. On its face this appears to be a subjective criterion imposing a very high bar to liability. This is ameliorated somewhat by the definition of "aware" Chapter 19 of the ASX Listing

[7] We refer to companies or groups of companies because some shareholder actions that arise from one set of circumstances have involved claims against more than one company within one corporate group; for example the class actions against Centro Properties Ltd and Centro Retail Ltd.
[8] See note 5 for the official list as at 28 September 2018.
[9] Australian Institute of Company Directors, *Submission 35* at 2-3.
[10] Risks and Insurance Management Society Australasia, *Submission 59* at 2.

Rules to include information that company officers ought reasonably to have come into possession of in the course of performing their duties. In substance, this imports an objective standard of reasonable conduct that is akin to negligence.

1.12 Similarly, disclosure obligations attach only to information that a "reasonable person would expect to have a material effect on the price…of the entity's securities", and ASX Listing Rule 3.1A.3, provides an exception to disclosure obligations for information if "a reasonable person would not expect the information to be disclosed".

1.13 The legislative framework and listing rules are replete with language which impose liability only in circumstances where conduct is not reasonable. The inevitable outcome of further restrictions on the level of fault required to establish liability for breaches of continuous disclosure obligations would be to absolve companies of liability in circumstances where they have engaged in unreasonable conduct. If, on an objective standard, the undisclosed information is not information it would be reasonable to expect an officer to have come into possession of, or that a reasonable person would not expect to be disclosed, no liability attaches.

1.14 In respect of misleading or deceptive conduct, to the extent that representations relate to present facts, the imposition of liability reflects the logical position that, as between a corporation which issues misleading representations about its own affairs and market participants who suffer loss as a result of those representations, the burden of making good that loss should lie with the party responsible for the misleading representation.[11]

1.15 In our experience, the central allegations of misleading or deceptive conduct in shareholder class actions more often turn on forward-looking statements, such as misleading profit and earnings guidance. This is a consequence of the fact that share prices are typically a function of the net present value of expected future cash flows, and thus it is future representations which tend to distort or correct market prices. The question of whether or not a statement about future matters is misleading or deceptive turns on whether or not it was made with a reasonable basis.[12] The existing legislative framework thus already functions in a manner similar to the "reasonable steps" defence which is advocated by Zurich Insurance Australia in its submission.[13]

1.16 Taking these features of the legislative regime into account, it is clear that companies which are committed to acting honestly and reasonably have no reason to fear exposure to shareholder class actions either as a result of the operation of Australia's continuous disclosure laws or the laws prohibiting misleading or deceptive conduct. Only those organisations which act unreasonably are really at risk of being found liable.

[11] See, for example *Yorke v Lucas* (1985) 158 CLR 661 at 675 per Brennan J.
[12] See *Corporations Act 2001* (Cth) s 769C; *Australian Securities and Investments Commission Act 2001* (Cth) s 12BB; *Clifford v Vegas Enterprises Pty Ltd (No 5)* [2010] FCA 916 at [232]; *Australian Securities and Investments Commission v ActiveSuper Pty Ltd (in liq*) [2015] FCA 342 at [457].
[13] Zurich Australia Insurance Limited, *Submission 49* at 3.

Immediate disclosure

1.17 Some submissions expressed concern about what is said to be an overly stringent requirement to disclose material information immediately. For example, RIMS argued that the requirement for immediate disclosure "provides a relatively low threshold for commencing a shareholder class action" because it "ignore[s] the practical realities for listed companies".[14] This submission is based on a misunderstanding of continuous disclosure requirements, which already allow for these practical realities.

1.18 ASX Listing Rules Guidance Note 8 explains, with reference to judicial authority on this point, that the requirement for immediate disclosure should not be read as requiring instantaneous disclosure. Rather it imposes a requirement to disclose information "promptly and without delay". Whether there has been an unacceptable delay depends on a range of factors, which may justify the elapse of time between an entity becoming aware of information and disclosure being made. ASX Listing Rules Guidance Note 8 sets out a non-exhaustive list of relevant factors, which may include the amount and complexity of the information involved, the need to verify its accuracy and the need to draft a complete and accurate announcement.[15]

1.19 The requirement for "immediate" disclosure is further qualified by several exceptions enumerated in ASX Listing Rule 3.1A, including an exception for information which "comprises matters of supposition or is insufficiently definite to warrant disclosure".[16] Thus, contrary to the suggestion that the listing rules impose an inflexible standard in respect of immediate disclosure, express provision is already made for the practical challenges faced by large organisations required to analyse complex information before making disclosure to investors.

1.20 As a practical matter, the question of what constitutes an acceptable delay in disclosing material information is of little significance in the context of shareholder class actions. Typically shareholder class actions allege breaches of continuous disclosure obligations continuing over a class period which extends for months or years, and are brought on behalf of shareholders who acquired shares within that period. A disclosure delay in the order of days or even weeks would be extremely unlikely to generate market distortion of sufficient duration to give rise to a viable shareholder class action given that the trading volume in such a short period would be relatively small.

1.21 A suggestion that the existing requirement for immediate disclosure should be weakened on the basis of a perceived risk of exposure to shareholder class actions is in effect a suggestion that that material information which is sufficiently definite to warrant disclosure, which a reasonable person would expect to be disclosed, which has been sufficiently analysed and verified by the company in question, and sufficient time allowed for an accurate and complete statement to be drafted, should nonetheless be permitted to be withheld from the market for some period of time.

[14] Risks and Insurance Management Society Australasia, *Submission 59* at 2-3.
[15] ASX Listing Rules - Guidance Note 8, 13-14.
[16] ASX Listing Rule 3.1A.1.

1.22 As a possible "solution" to the perceived problem regarding immediate disclosure, RIMS advocates the adoption of "American-style 'periodic disclosure' obligations".[17] However the empirical evidence cited by RIMS in support of their submission in fact concludes that the primary distinction between the Australian and US regimes is the existence in Australia of statutory backing for private rights of redress in respect of continuous disclosure breaches, and that as a result Australia's continuous disclosure regime has been significantly more successful in creating a stable and fully informed market.[18] In other words the evidence cited by RIMS in support of loosening disclosure requirements is in fact evidence of the benefits of our existing disclosure regime. For the reasons canvassed in our primary submissions, there is not only a benefit to the market from the standpoint of stability and integrity, it also operates to reduce the prevalence of shareholder litigation by limiting the frequency of earnings surprises.

D&O insurance

1.23 One of the dominant themes in the submissions of those who support less onerous disclosure obligations relates to the cost and availability of D&O insurance.

1.24 Many of these submissions are made on the basis of generalised assertions that are unsupported by objective data or empirical evidence regarding the cost and availability of D&O insurance. One of the only sources of data is the submission by Marsh, which is an insurance broker (which therefore represents the interests of listed companies who are seeking to acquire D&O insurance).

1.25 In our submission, the available evidence simply does not support the conclusion that there is a crisis or problem in the market for D&O insurance, and recent increases in premiums for D&O insurance are more likely to point to chronic under-pricing of D&O insurance over an extended period of time, with the price of premiums more recently being corrected and normalised.

1.26 Marsh's submission notes that the average annual premium paid by its ASX200 clients for D&O insurance currently stands at approximately $1.86 million.[19] Given the size of ASX200 companies (both in terms of revenue and capacity to distort the market), without context an absolute value such as this is of little assistance in evaluating the financial burden or proportionality of such premiums.

1.27 A recent survey of 167 of the ASX200 companies' financial results shows that the average net profit for an ASX200 company is in the order of $470 million.[20] Premiums of $1.86 million would therefore amount to less than 0.5% of the average clear profit of an ASX200 company. Needless to say there will be significant variability both in

[17] Risks and Insurance Management Society Australasia, *Submission 59*.
[18] Stephen Brown and Chander Shekhar, "Continuous Disclosure in Australia and the United States: A Comparative Analysis" (August 2016), 23-26.
[19] Marsh Australia, *Submission 11* at 4.
[20] See earnings data for 167 of the ASX 200 listed companies in Craig James and Ryan Felsman, 'Earnings Season: Corporate Australia in the Black' (28 February 2018), accessible at: https://www.commsec.com.au/content/dam/EN/ResearchNews/ECO_Insights_010318-Corporate-Profit-Reporting-Season.pdf. For the purpose of this estimate half year earnings figures were extrapolated to a 12 month period.

the net profit and in premiums for D&O insurance among ASX200 companies, however these average values provide an insight into the financial burden of D&O insurance. In our submission it does not indicate that the cost of D&O insurance is prohibitive or unaffordable. A better comparison would have analysed the cost of premiums relative to top line revenue, however data regarding revenue of the 167 companies mentioned above was not available in the survey to which we have referred: suffice to say that the cost of D&O premiums would be an even more miniscule proportion of ASX200 companies' revenue.

1.28 Marsh also asserts that a number of insurers have withdrawn from the market because they "are so concerned with the state of the D&O environment and the risk factors associated with providing cover for securities class actions". None of the insurers who have apparently withdrawn from providing D&O insurance have made submissions to the inquiry, so the submission by Marsh needs to be evaluated on the basis that the real commercial reasons for the withdrawal of some insurers have not been revealed and are unknown.

1.29 The question needs to be asked whether the real underlying reasons for the withdrawal of some insurers are the competitive dynamics in the market for D&O insurance. For example, hypothetically if a major market participant decided not to increase its premiums in an attempt to increase its market share, this might put pressure on other insurers either to match the first insurer's prices, which they may not wish to do for commercial reasons, or alternatively not to offer the product at all.

1.30 The question also needs to be asked whether increases in premiums for D&O insurance are solely or predominantly due to perceptions regarding risks associated with shareholder class actions. Of course D&O insurance provides cover for a wide range of different types of liability on the part of directors and officers, and we have seen no acknowledgment or discussion of the influence of other types of liability on the cost of D&O insurance premiums. Rather, submissions by those who say that D&O insurance is too costly seem to assume that increases in D&O insurance are solely attributable to shareholder class actions and do not, for instance, have anything to do with regulatory action, commissions or inquiries or other types of private claims against directors and officers.

1.31 Only one provider of D&O insurance (Zurich) elected to make a submission to the inquiry. Zurich submitted that:

> Continuous disclosure laws are a necessary feature of Australia's corporate law landscape that ensure an efficient market and the correct value of a corporation's securities. Accordingly, it is not Zurich's submission that those laws should be narrowed in any way.

1.32 We agree. In our submission there is no justification for a review of our continuous disclosure laws. There is no reason to conclude that the continuous disclosure regime has been productive of undesirable or unacceptable economic impacts or that it has created legal obligations that are unfair or overly onerous in their application.

2. CERTIFICATION AND LEAVE TO PROCEED

Certification

2.1 We welcome the ALRC's view that the introduction of a certification procedure would not enhance practice and procedure in the Federal Court's class actions regime.[21] In light of the ALRC's view, it is unnecessary to repeat the reasons why a certification procedure is undesirable, however we note that:

(a) the substantial majority of submissions to the recent inquiry by the Victorian Law Reform Commission (**VLRC**) did not support a certification process;[22]

(b) ultimately the VLRC concluded that "there is no need to introduce [a certification procedure] into Victoria's class actions regime, and many reasons not to do so";[23]

(c) a certification procedure was not contemplated in the ALRC's Discussion Paper, and as far as we are able to discern, only a very small number of submissions advocated its introduction.[24]

Leave to proceed

2.2 We do not support the introduction of a "leave to proceed" mechanism.

2.3 *First*, to the extent that the factors to be considered in an application for leave to proceed simply reflect the existing requirements of the Part IVA regime or the Class Actions Practice Note (GPN-CA), in our submission a leave to proceed mechanism:

(a) is an inapt context in which to consider those factors;

(b) is redundant; and

(c) will offer no practical benefit or utility to the Court or to applicants, class members or respondents in a vast majority of cases.

2.4 In the ALRC's Supplementary Note it is suggested that the application for leave to proceed will require the parties (including, presumably, the respondents) to address the matters currently specified in [7.6]-[7.8] of GPN-CA. However it is difficult to understand how many or most of those matters could or should have any bearing on the issue of whether the Court ought to grant leave to proceed.

2.5 Almost all of the matters specified in [7.6]-[7.8] are general case management issues such as the timetable for delivery of a defence, discovery issues including the utility of orders for the respondent to give evidence as to the types of documents that exist

---

[21] Australian Law Reform Commission, *Supplementary note for consultation: Leave to proceed* (2018) (**Supplementary Note**) at [1.13].
[22] Victorian Law Reform Commission, *Access to Justice – Litigation Funding and Group Proceedings* (March 2018) (**VLRC Report**) at [4.41].
[23] VLRC Report at [4.57].
[24] See for example Michael Legg and James Metzger, *Submission 12*.

and the form and location in which they are stored or held, security for costs, timetabling of interlocutory applications and further case management hearings as well as (as specified in [8.2] of GPN-CA, which is incorporated by virtue of [7.8(h)]) issues such as the joinder of additional parties, whether sub-groups should be formed or sample class members put forward, the timing of the opt out notice, methods of communicating with class members, common and other questions for trial, the appropriateness of a split trial, the provision of expert reports and potential use of joint expert reports or concurrent evidence or referees as well as the mode of conducting the trial. These are all matters that are appropriately addressed in a case management context and not as criteria or considerations that should have any bearing on a decision about whether leave to proceed should be granted.

2.6 In the ALRC's presentation at the post-submission seminars for the inquiry, it was also suggested that the criteria by which the Court is to decide whether to grant leave to proceed should be those set out in sections 33C and 33D of the *Federal Court of Australia Act 1976* (Cth).[25] These provisions simply specify the threshold criteria for the commencement of class actions (numerosity, connectivity and commonality) and the standing of the representative applicant.

2.7 If a respondent considers that the class actions regime has not been properly engaged because the criteria in section 33C (especially) and section 33D have not been met, they are already able to seek appropriate relief. Importantly, however, the empirical evidence establishes that:[26]

(a) applications concerning the representative character of class actions are relatively infrequent, with empirical data showing that these "decertification" applications[27] were brought in 28.4% (71) of cases up to March 2009;

(b) respondents have enjoyed a low success rate in their decertification applications: as at March 2009, the respondent had succeeded in only 19% (13) of all decertification applications, which means that respondents had made successful decertification applications in only around 5% of all class actions that were incorporated in the empirical study; and

(c) respondents have had a constantly diminishing success rate over time: in the period from 2004 to 2009, none of the 20 decertification applications were successful, compared to a 40% success rate in the first five years of the Part IVA regime.

2.8 These data suggest that current practice is now working well insofar as plaintiffs are commencing properly constituted class actions that satisfy the threshold criteria for their commencement, and in our submission it is unnecessary to overlay an additional and superfluous procedural mechanism that will have no practical utility in a vast majority cases. The existing procedures (including the relief that is available to

[25] Australian Law Reform Commission, *Inquiry into Class Action Proceedings and Third-Party Litigation Funders: Post-submission seminar* (September 2018) at 27.
[26] V Morabito & J Caruana, "Can Class Action Regimes Operate Satisfactorily without a Certification Device? Empirical Insights from the Federal Court of Australia" (2013) 61 *American Journal of Comparative Law* 579 at 594, 597-8.
[27] The data include applications under section 33N of the FCA Act.

respondents) are adequate and appropriate to ensure that class actions are properly commenced and that they meet the fundamental threshold criteria for the engagement of the Part IVA regime.

2.9 *Secondly*, although the apparent intent of the leave to proceed mechanism is that it should be more confined and limited in scope than a certification procedure, we are concerned that that intent may be frustrated in practice. In particular, we understand that a leave to proceed mechanism would not be intended to involve consideration of the substantive merits of the pleaded case (as is the case in certification procedures in overseas jurisdictions), however the ALRC's proposal leaves open the possibility that respondents will seek to agitate against leave to proceed being granted on the basis of arguments regarding the merits of the claim. If the leave to proceed mechanism were to require the parties to address the matters in [7.6]-[7.8] of GPN-CA, this would include:

(a) the issues and facts that appear to be in dispute ([7.6] of GPN-CA);

(b) the description of the class ([7.8(a)] of GPN-CA);

(c) other pleading issues ([7.8(c)] of GPN-CA).

2.10 Depending on how jurisprudence and practice develops in relation to a requirement for leave to proceed, there is the prospect that the mechanism will degenerate into the type of undesirable procedure that has led to significant costs and delay in overseas jurisdictions where certification is mandated.[28] For example, in arguing against leave to proceed, respondents may seek to adduce evidence regarding the merits of the case and this will mean that applicants will need to respond to such evidence, potentially at significant cost and with associated delay. If a leave to proceed mechanism is ultimately recommended by the ALRC in its final report, in our submission the recommendation for reform should be expressed in terms that explicitly prevent the intrusion of merits disputes into the procedure.

2.11 *Thirdly*, the ALRC's Supplementary Note at [1.18(1)] suggests that the order regarding leave to proceed may involve the Court rejecting, varying or setting the commission rate or contingency fee percentage. In our submission this may be impractical and inopportune: the more appropriate occasion for the Court to make such orders is at a later stage of a class action and in particular at the time of the proposed resolution of the claim. For example, some of the factors that may influence the Court's determination regarding the commission rate or contingency fee percentage include the quantum of any settlement, the stage at which the class action was resolved and risk involved as well as the scope of the work that needed to be undertaken by the applicant's lawyers.

2.12 *Fourthly*, although it is contemplated that the leave to proceed mechanism would be used in order to manage the resolution of competing class actions, it will apply in all class actions regardless of whether there are competing actions, and it will therefore generate additional costs and potentially also delay in all class actions regardless of whether there are competing claims.

[28] For a summary of the issues, see the VLRC Report at [4.48]-[4.54].

3. OVERLAPPING / COMPETING CLASS ACTIONS

3.1 We support the increased flexibility that has been introduced into the proposal for competing class actions (as outlined in Recommendation 6-2) insofar as consolidation is now proposed as one of the default options.

3.2 However in circumstances where plaintiffs in different actions are not able to reach agreement regarding consolidation, we remain concerned at the limited options that will become entrenched as the default approach to competing class actions. In particular we are concerned that:

(a) there will continue to be an undue focus on "price" (in terms of legal costs and funding commissions), while devaluing the importance of other criteria in the context of carriage motions;

(b) the proposal is based on a flawed premise that the "class" is essentially monolithic. It remains unclear how the Court will in practice grapple with substantive differences in claims that might be advanced in competing or overlapping class actions; for example, in the series of class actions filed against AMP there are significant differences in the claim period and case theory among the five overlapping claims. By retaining default options that are limited to determining (at an early stage) that a single proceeding will progress (either after a carriage motion or by consolidation), the practical consequence is that this will likely encourage a lowest common denominator approach resulting in pleading of longer periods and multiple causes of action. In our submission this is not in the interests of class members, the Court or defendants.

3.3 We do, however, welcome the ALRC's current thinking[29] to the effect that class member sign up – as a proxy for class member preferences – should be a key criteria for carriage motions to the extent that they are a feature of any new procedure for competing claims.

---

[29] Australian Law Reform Commission, *Inquiry into Class Action Proceedings and Third-Party Litigation Funders: Post-submission seminar* (September 2018) at 25.