

# SHAREHOLDER CLASS ACTIONS – A CRITICAL ANALYSIS OF THE PROCEDURE UNDER PART IVA OF THE FEDERAL COURT OF AUSTRALIA ACT

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*Part IVA of the Federal Court of Australia Act 1974 (C'th) governs the class action procedure, which has been available in Australia since March 1992. The procedure was not popular amongst the shareholders until in the late 1990s, and since then the number of shareholder class actions has steadily increased. Many of these shareholder class actions settled before a final court hearing. This article critically examines the class action procedure and in doing so, it highlights the current issues that contribute to a rapid rise in shareholder class actions. The article calls for reform to the class action procedure. It identifies areas for reform in an attempt to improve the position of the group members so that they can receive a better outcome than what they can get under the current class action model.*

## I INTRODUCTION

The statutory class action came into effect in March 1992. Prior to that, there was no common law equivalent. The class action is governed under Part IVA of the *Federal Court of Australia Act 1976* ("FCAA") and it can be used in any situation. A minimum threshold is that a representative plaintiff must prove that at least seven members in that group or class have the same, similar or related circumstances in respect to their claims against the same defendant.<sup>1</sup> For example, a shareholder who has suffered a financial loss because of the company's failure to disclose full financial position of the company at the relevant time may have a right to launch a class action on behalf of all shareholders affected by the same, similar or related circumstances against the company and its directors.

Part IVA was not in use by shareholders until almost a decade later, with the first reported case appearing in the Federal Court of Australia in 1999-

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<sup>1</sup> Section 33C of the FCAA

2000.<sup>2</sup> Since then, Part IVA has become a popular source of remedy for shareholders in Australia.<sup>3</sup> However, the majority of shareholder class actions have settled before a final judgment. It is not clear why many of these class action cases have settled before a final hearing. One possible reason could be due to the difficulty of proving causation. Currently, there is no easy way for a plaintiff to prove causation in a case where the pool of class members is unusually large.<sup>4</sup> Another possible reason could be due to the ambiguity in the application of the “opt out” mechanism referred to in Part IVA under s.33J, particularly when a class action is commercially funded by a third party litigation funder.<sup>5</sup>

Since the introduction of the statutory class action procedure, no amendment has taken place for Part IVA. The purpose of this article is to examine whether there is a need for amendment to Part IVA. It is the view of the author that the Australian “opt out” class action is ineffective as a shareholder remedy when the court action is commercially funded by a third party litigation funder. There is no real opportunity for group members to opt out of the class proceedings when a litigation funder is involved. In order to stay in line with the growing acceptance of third party litigation funding, it is important for the “opt out” provision to be amended.

This article begins in Part 2 with a brief overview of the class action procedure and the inherent issues with the opt-out provision. In order to have a clear understanding of why the class action procedure is ineffective as a shareholder remedy, Part 3 explains briefly the litigation funding concept and how it works in class action cases. Part 4 reviews some of the shareholder class action cases to illustrate the complexity in the interpretation of the “opt out” provision in s.33J. There is no consistency in the application of s.33J. The courts have gone from a literal interpretation approach to an approach with a closed class that excludes non-funded group members from a commercially funded class action. Part 5 examines areas of incompatibility between the class

<sup>2</sup> The first reported shareholder class action was *King v GIO Australia Holdings Limited* (2000) 174 ALR 715, (2000) 100 FCR 209, [2000] FCA 1543; *King v. AG Australia Holdings Limited (formerly King v. GIO Australia Holdings Ltd)* [2003] FCA 980

<sup>3</sup> There are at least 30 reported cases on shareholder class actions and many of these were commercially funded – see [www.allens.com.au/pubs/ldr/papldrfb14\\_02.htm](http://www.allens.com.au/pubs/ldr/papldrfb14_02.htm) on “Shareholders class actions in Australia” (accessed 28 April 2015)

<sup>4</sup> See D. Grave, L. Watterson and H. Mould, “Causation, loss and damage: Challenges for the new shareholder class action” (2009) 27 *Companies and Securities Law Journal* 483; J Beach, “Class actions: Some Causation Questions” (2011) 85 *Australian Law Journal* 579; and D. Pompilio, “Will the fraud on the market theory be adopted in Australia (2012) 40 *Australian Business Law Review* 77

<sup>5</sup> Vince Morabito in his article has made a point that an “opt out” class action in Australia could be misused as an “opt in” action when a commercial litigation funder is funding the case. See V. Morabito, “Judicial responses to class action settlements that provide no benefits to some class members” (2006) 32 *Monash University Law Review* 75-115

action procedure and commercial litigation funding and suggests areas for reform. Part 6 is the conclusion.

This article is about the class action and Part IVA of the FCAA. There will be some discussion on commercial litigation funding, but this is only to explain why there are problems with the class action procedure when a litigation funder is involved in the class action.

## II OVERVIEW OF THE AUSTRALIAN CLASS ACTION

### A *The procedure*

The class action in Australia came into effect in March 1992.<sup>6</sup> Part IVA of the *Federal Court of Australia Act 1976* (“FCAA”) governs the class action procedure. It is termed a “representative proceeding” in Australia. Section 33C identifies the threshold criteria that must be met for a proceeding to be commenced as a representative proceeding in Australia:

[W]here:

- (a) seven or more persons have claims against the same person; and the claims of all those persons are in respect of, or arise out of, the same, similar or related circumstances; and
- (b) the claims of all those persons give rise to a substantial common issue of law or fact;
- (c) a proceeding may be commenced by one or more of those persons as representing some or all of them.

In effect, a class action is possible if (a) seven or more persons have claims against the same defendant; (b) their claims are in respect of or arise out of the same, similar or related circumstances; and (c) they have a substantial common issue of law or fact. These are the threshold requirements for commencing a class action in Australia. If these requirements are met, then any person in that group can commence a class action on his or her own behalf and on behalf of other persons referred to in s.33C.<sup>7</sup>

Section 33H sets out the type of document required to be filed in court to commence a class action. It reads:

- (1) An application commencing a representative proceeding, or a document filed in support of such an application, must, in addition to any other matters required to be included:
  - (a) describe or otherwise identify the group members to whom the proceeding relates; and

<sup>6</sup> Victoria also has class action provisions similar to the Federal legislation. The class action in Victoria is located in Part 4A of the *Supreme Court Act 1986* (Vic.) and it came into effect in January 2000. For ease of discussion, this article will focus only on Part IVA of the *Federal Court of Australia Act 1976* (C’t’h).

<sup>7</sup> Section 33D, FCAA

- (b) specify the nature of the claims made on behalf of the group members and the relief claimed; and
  - (c) specify the questions of law or fact common to the claims of the group members.
- (2) In describing or otherwise identifying group members for the purposes of subsection (1), it is not necessary to name, or specify the number of, the group members.

In other words, the drafting of the originating process and/or the statement of claim must comply with s.33H. The representative plaintiff is required to prove that he or she satisfies the class membership as identified in the originating process and/or the statement of claim. In short, the drafter of the statement of claim must comply with s.33C.

An important point to note under s.33H(2) is that it is not necessary for the originating process or the statement of claim to contain names of the group members or to specify the number of group members. This means that the representative plaintiff may be representing numerous unidentified group members who may be eligible to participate in the class action but may choose to remain anonymous for as long as possible. These unidentified group members may decide to come forward only when they hear of the successful outcome in the class action or when they hear about an out of court settlement, at which time they may decide to identify themselves and put in a claim for a share of the winnings.<sup>8</sup> The delay in coming forward could be as late as when they hear about the proposed settlement.

Section 33X and 33Y provide the court with a broad discretion to determine when and how a notice is to be served on the group members and to determine the content of the notice and the manner of service, and such notice may be given “by means of press advertisement, radio or television broadcast or by any other means”. There is no requirement for a party to inform the group members personally unless the court determines that it is reasonably practical and not unduly expensive.<sup>9</sup> However, the failure of a group member to receive or to respond to a notice does not affect the next step in the proceeding or the judgment given in the proceeding.<sup>10</sup>

Section 33J provides a way for group members to opt out of the class action. It reads:

- (1) The Court must fix a date before which a group member may opt out of a representative proceeding.

<sup>8</sup> Section 33E of the FCAA does not require consent from a representative plaintiff to be a group member, which means that any person who satisfies the criteria under s.33C and who identifies himself as being in the group as described in the originating process as required by s.33H will be a group member in that particular class action and be entitled to claim for a share of the compensation.

<sup>9</sup> Section 33Y(5) of the FCAA

<sup>10</sup> Section 33Y(8) of the FCAA

- (2) A group member may opt out of the representative proceeding by written notice given under the Rules of Court before the date so fixed.
- (3) The Court ... may fix another date so as to extend the period during which a group member may opt out of the representative proceeding.
- (4) ...

Essentially s.33J provides group members with an opportunity to opt out if they do not wish to be bound by the decision in the class proceeding.<sup>11</sup> Members can opt out of the proceeding by filing a notice in court before the due date as set out by the court.

### B *Problems with the “opt out” provision*

Later in this article, shareholder class actions will be used to illustrate why the opt out model is ineffective when a litigation funder is involved in the case. For now, the opt out provision in itself has its own problems.

There is a lack of clarity and purpose in the opt-out provision. It is not clear what the implications will be if a group member who wishes to opt out of the class action has not in fact opted out by the due date. Normally in this instance, a member is bound by the decision of the court.<sup>12</sup> However, there are two possible scenarios on why some group members have not taken part in the claim for a share of the compensation in the successful class action. First, it could be that some members were not aware of the existing class action; and second, it could be that the compensation amount overall might be too small or insufficient to cover the losses that they may decide that there is no point in putting in a claim. The question then is whether these group members should be given leniency and be permitted to pursue a court action on their own, for example an oppression action under Part 2F.1 of the Corporations Act 2001 (C’th) if the member is a shareholder. Section 33J has not provided any exception to cover these situations, which could pose a number of problems.

#### 1 *Some members may be missing out on a claim for compensation*

Section 33J states that a group member who does not want to be a part of the class proceeding may file a notice in court to opt out. However, the provision provides no guidance on how a group member can go about opting out. Generally, it is unlikely that any person would make any decision about the class proceeding in respect to whether or not to opt out unless:

- (a) the person is aware of the class proceeding at the relevant time;

<sup>11</sup> Section 33ZB of the FCAA refers to the judgment of the court as binding on all group members, except those who have opted out of the class action.

<sup>12</sup> Section 33ZB(b) of the FCAA

- (b) the person has been informed that he or she is an eligible member of that class; and
- (c) the person has received sufficient information regarding the advantages and disadvantages of opting out of the class proceeding.

It is not uncommon to find many people in the community to be ignorant of their legal rights. There are people who cannot financially afford to engage a lawyer to ask the question: “Am I eligible to be a member of that class action?” In *King v. GIO Australia Holdings Ltd*, the court ruled that the statement of claim must define group membership with clarity, as this would enable people to decide their eligibility status and to decide whether they should opt out of that class proceeding.<sup>13</sup> However, without adequate legal advice, the majority of people in the general public would have difficulty in understanding the significance of that point. People are often reluctant to make any decision if they do not have a clear understanding of the law.

The other difficulty is, even if people have some understanding that they are eligible to be in that class proceeding, they may not have sufficient information to weigh up for themselves the advantages and disadvantages of opting out, and again they may be financially constrained in seeking legal advice. The alternative for these people would be to do nothing under s.33J.

In *Bright v. Femcare*, the court noted that, “in many cases a substantial number of members of the represented group will be unknown”.<sup>14</sup> Cashman, in reference to class proceedings, made a similar comment that “the identity of all of the affected individuals will also be difficult, if not possible, to ascertain...”.<sup>15</sup> Clearly, there will always be members who do not know whether they are *in* the group proceedings or *not in* the group proceedings. Elderly and fragile people and migrants with limited English are the ones who may be most at risk of not knowing what to do and are therefore less likely to make inquiries. These people will often miss out on making a claim for compensation as a member.

It is questionable whether a group member who has not opted out at the relevant time can later pursue a separate court action. Although, it is clear that the provision provides an opportunity for a group member to opt out of the class action, there is a general lack of clarity on the actual purpose and intent.

## 2 Some members may not want to take part in the claim for compensation

Another complication with s.33J is that some group members may be dissatisfied with the outcome of the class proceeding and may not want to take

<sup>13</sup> *King v. GIO Australia Holdings Ltd* [2001] FCA 270. This case will be discussed further in Part 4 of this article.

<sup>14</sup> *Bright v. Femcare* [2000] FCA 1179 at [19] (per Lehane J)

<sup>15</sup> P. Cashman, “Class actions on behalf of clients: Is this permissible?” (2006) 80 *Australian Law Journal* 738 at 738

part in the claim for compensation. The difficulty arises when these members have not opted out of the class proceedings as per s.33. Their intention is to have a second attempt at suing the same defendant, perhaps on a different ground in the hope of a better outcome. The problem for the court would be to decide whether these members can still bring a court action on their own, such as an oppression action under Part 2F.1 of the *Corporations Act* 2001 (C'th) which a minority shareholder can pursue, or whether the court can reject their applications for a second hearing.

A minority shareholder can bring an “oppression” action if the conduct of the company’s affairs or the act of the directors is:

contrary to the interests of the members as a whole; or oppressive to, unfairly prejudicial to, or unfairly discriminatory against a member or members whether in that capacity or in any other capacity.<sup>16</sup>

The advantage of bringing an oppression action is that the remedy awarded by the court may be *personal* to the shareholder. There is a long list of remedies available to a shareholder in a successful oppression action.<sup>17</sup> For example, the court can order the company to buy back shares currently held by the oppressed shareholder.

In an attempt to sue the same defendant again, some group members may rely on the argument that they had no knowledge of the previous class action, or they did not know they were eligible to be in that class, and therefore they did not know about the need to opt out of the class action under s.33J.

Currently there is no case law dealing with this issue. However, the above scenario does present a need for consideration as to whether s.33J needs to be made clearer to avoid multiple interpretations and outcomes.

### III COMMERCIAL LITIGATION FUNDING

As mentioned earlier, s.33J provides an opportunity for group members to opt out of the class action if they do not wish to be bound by the court decision. However, since commercial litigation funding has become available in 2006, it has become more difficult for members to exercise their right to opt out under s.33J. This difficulty is not imposed by the legislative framework (because the class action provisions have not changed) but is imposed by a litigation funder through its written agreement with group members who need funding to commence a class action. Below is a brief discussion of how commercial litigation funding works. The key point is that the underlying purpose of s.33J has become blurred when there is a commercial litigation funder involved in

<sup>16</sup> Section 232, *Corporations Act* 2001 (C'th)

<sup>17</sup> Section 233 of the *Australian Corporations Act* 2001 (C'th) provides a list of 10 different orders that the Court can make in a successful oppression claim, and the list does not include damages.

the class proceeding.

### A Commercial litigation funding

In 2006 in the case of *Campbells Cash and Carry v. Fostif* (“*Fostif*”), the High Court by a majority of 5:2 permitted a commercially funded retailer class action to proceed.<sup>18</sup> This was the first case where the High Court formally accepted the important role of a commercial litigation funder in court proceedings. The High Court found that litigation funding by a third party was not contrary to public policy nor was it an abuse of process.<sup>19</sup> It was noted that the idea of commercial litigation funding had made it possible for some plaintiffs to bring their case to court and seek justice.<sup>20</sup> Kirby J added:<sup>21</sup>

... The individual claim may (as in the case of many tobacco retailers in these proceedings) be comparatively small and hardly worth the expense and trouble of suing. But the aggregate of the claims of those willing to proceed together, as proposed by a funder and organiser such as Firmstones, might be very large indeed. What is a theoretical possibility, as an individual action or series of actions, needs therefore to be converted into a practical case by the intervention of someone willing to undertake a test case (258), followed by others willing to organise litigants in a similar position, and under appropriate conditions, to recover their legal rights by helping them to act together.

In *Dawson Nominees Pty Ltd v. Multiplex Limited*,<sup>22</sup> a shareholder class action case, Finkelstein J of the Federal Court of Australia made a similar comment:<sup>23</sup>

The advantage of the retainer and the funding agreements to each group member is obvious. If it were not for those agreements and the class action procedure, the action would probably not have gotten off

<sup>18</sup> *Campbells Cash and Carry v. Fostif* [2006] HCA 41; (2006) 229 CLR 386 (Gleeson CJ, Gummow, Kirby, Hayne and Crennan JJ; with Callinan and Heydon JJ dissenting)

<sup>19</sup> This ruling was further supported by the High Court in a subsequent case, *Jeffrey and Katauskas Pty Ltd v. Rickard Constructions Pty Ltd* (2009) 83 ALJR 1180 (French CJ, Gummow, Hayne and Crennan JJ; with Heydon J dissenting).

<sup>20</sup> It should be noted that the decision in *Campbells Cash and Carry v. Fostif* [2006] HCA 41; (2006) 229 CLR 386 marks the end of the doctrines relating to maintenance and champerty in Australia. Historically, maintenance (improperly encouraging litigation) and champerty (receiving a share of the win in exchange for maintaining the court case) were strictly prohibited in all Australian jurisdictions. For a discussion of the development of the doctrines of maintenance and champerty, see the judgment of Gummow, Hayne and Crennan JJ in *Campbells Cash & Carry Pty Ltd v Fostif Pty Ltd* [2006] HCA 41; (2006) 229 CLR 386. See also Damian Grave and Ken Adam, *Class Actions in Australia*, 2<sup>nd</sup> edition, 2012, Thomson Reuters

<sup>21</sup> *Campbells Cash and Carry Pty Ltd v. Fostif Pty Ltd* [2006] HCA 41; (2006) 229 CLR 386, at 449 (per Kirby J); Gleeson CJ, Gummow, Hayne and Crennan JJ expressed similar sentiment in the same case

<sup>22</sup> *Dawson Nominees Pty Ltd v. Multiplex Limited* [2007] FCA 1061

<sup>23</sup> *Dawson Nominees Pty Ltd v. Multiplex Limited* [2007] FCA 1061, at para 34 (Finkelstein J).



the ground. Individually, most group members would not have the financial strength to bring their opponents to court. For those that do the potential benefits of bringing an action would be outweighed by the quantum of the costs.

Currently, a commercial litigation funder is not required to have an Australian Financial Services Licence (AFSL). In *International Litigation Partners Pte Ltd v. Chameleon Mining NL (receivers and Managers Appointed)*,<sup>24</sup> the High Court was requested to interpret the term “managed investment scheme” under chapter 7 of the *Corporations Act 2001* (C’th) to determine whether a litigation funder was required to have an AFSL. It was held that commercial litigation funding was *not* a managed investment scheme as such and thus the funder was exempt from the requirement of an AFSL. Subsequently, the legislature passed a piece of law on 13 January 2013 to confirm the High Court’s interpretation on this point.<sup>25</sup>

At present, the only specific law that a litigation funder is required to comply with, which came into effect on 13 January 2013, is putting together a plan for managing conflict of interests with the clients and with the clients’ lawyers.<sup>26</sup> There are no other specific laws that govern litigation funders.

Unlike lawyer’s professional fees that are regulated by specific legislation, a commercial litigation funder is *not* subject to any fees restriction. A litigation funder is free to impose any fees on group members for financing their class proceeding.

Overall, the litigation funding industry is still largely unregulated and this may have accounted for the rise in the number of shareholder class actions in Australia since 2006. The government has been under pressure to introduce laws to monitor commercial litigation funders. In its latest report, *Access to Justice Arrangement*, released on 3<sup>rd</sup> December 2014, the Productivity Commission made several recommendations:<sup>27</sup>

The Australian Government should establish a licence for third party litigation funding companies designed to ensure they hold adequate capital relative to their financial obligations and properly inform

<sup>24</sup> *International Litigation Partners Pte Ltd v. Chameleon Mining NL (receivers and Managers Appointed)* [2012] HCA 45

<sup>25</sup> The *Corporations Amendment Regulations 2012* (No.6) was passed on 12 July 2012 and came into effect on 13 January 2013. The relevant provision is now located in reg 5C.11.01 of the *Corporations Regulations 2001* (C’th)

<sup>26</sup> *Corporations Amendment Regulation 2012* (No.6). Australian Securities and Investment Commission has put together a set of guidelines, known as ASIC Regulatory Guide 248, for litigation funders to follow.

<sup>27</sup> Productivity Commission, *Inquiry Report on Access to Justice Arrangements*, Volume 2, Final Report No 72, 5 September 2014, Canberra, Recommendation 18.2 at page 633. The Report was released for public viewing on 3<sup>rd</sup> December 2014.

clients of relevant obligations and systems for managing risks and conflicts of interest.

- Regulation of the ethical conduct of litigation funders should remain a function of the courts.
- The licence should require litigation funders to be members of the Financial Ombudsman Scheme.
- Where there are any remaining concerns relating to categories of funded actions, such as securities class actions, these should be addressed directly, through amendments to underlying laws, rather than through any further restrictions on litigation funding.

This Report is currently being considered in Parliament.

### B *How does commercial litigation funding work?*

A commercial litigation funder makes its money from funding court cases, mostly class actions. Group members who agree to sign the funding agreement with a litigation funder will effectively be *opting into* the funding arrangement. Common practice is that a litigation funder will fund all legal costs and expenses incurred in the class action such as a shareholder class action, and this includes providing any security for costs required by the court.<sup>28</sup> In return, group members must agree to:<sup>29</sup>

- (1) pay all costs and expenses to the litigation funder when there is a successful outcome in the class action or when a group member withdraws from the case before it is settled; and
- (2) pay the litigation funder an agreed commission from the amount recovered in the successful class action, and this could either be an agreed settlement approved by the court or through a final court judgment.

Given that the commercial litigation funding industry is still largely unregulated, the commission for which a litigation funder can charge is unlimited. It has been known that a litigation funder has charged a commission of two-thirds of the net recovery from a successful class action.<sup>30</sup> As will be seen later in this article, the courts have had a chance to monitor the litigation funding agreements, but have not issued an order to scale back the

<sup>28</sup> See, Morabito V, "Corporate Accountability, Third Parties and Class Actions" from Corporate Law and Accountability Research Group, Working Paper No. 3, October 2006, at pp.17-18.

<sup>29</sup> The way these two conditions work is illustrated in the analysis of shareholder class action cases in Part 4 of this article.

<sup>30</sup> See Morabito V, "Corporate Accountability, Third Parties and Class Actions" from Corporate Law and Accountability Research Group, Working Paper No. 3, October 2006, at p.18; see also a report from the Standing Committee of Attorneys-General, *Litigation Funding in Australia* (Discussion Paper, May 2006) p.4.

litigation funder's fees.

Generally, the funding agreement is prepared in a way that benefits the litigation funder. When a group member decides to opt out of the funding arrangement or decides to opt out of the class action under s.33J, the group member is expected to reimburse legal costs and expenses already incurred for commencing the class action.

The term "commercial litigation funding agreement" is not the same as the term "contingency fees agreement", the latter being commonly used in the United States.<sup>31</sup> Australian law prohibits the use of "contingency fees agreement" or "contingency fees arrangement".<sup>32</sup> Instead, the "commercial litigation funding agreement" is the alternative as approved by the High Court in 2006. The key difference between the two is that in a contingency fees arrangement, as used in the United States, lawyers acting for the client have an agreement to deduct a portion of the net recovery if there is a successful outcome in the court case. By contrast, a commercial litigation funding arrangement is usually an agreement between a third party litigation funder and the lawyers' client; this arrangement works in Australia as a way of avoiding any conflict of interests between the lawyers and the client. A third party litigation funder is not constrained by the same prohibition as the acting lawyers.<sup>33</sup>

#### IV SHAREHOLDER CLASS ACTIONS AND ITS INTERACTION WITH COMMERCIAL LITIGATION FUNDING

These days, the majority of the class action cases are commercially funded.<sup>34</sup> The discussion under this part is to review several of the more important shareholder class actions in order to understand how the operation of s.33J has become blurred when a commercial litigation funder is involved.

<sup>31</sup> For reading on the United States contingency fees arrangement, see Macey JR and Miller GP, "The Plaintiffs' Attorney's Role in Class Action and Derivative Litigation: Economic Analysis and Recommendations for Reform (1991) 58 *University of Chicago Law Review* 1. See also, Lambert KA, "Class Action Settlements in Louisiana", (2000) 61 *Louisiana Law Review* 89; and Mulheron R, *The Class Action in Common Law Legal System: A Comparative Perspective* (Oxford, Hart Publishing, 2004)

<sup>32</sup> See, for example, *Legal Profession Act 2004* (Vic) s 3.4.29(1)(b); *Legal Profession Act 2006* (ACT) s 285; *Legal Profession Act 2004* (NSW) s 325(1)(b); *Legal Profession Act 2006* (NT) s 320(1); *Legal Profession Act 2007* (Qld) s 325; *Rules of Professional Conduct and Practice 2003* (SA) r 42; *Legal Profession Act 2007* (Tas) s 309(1); *Legal Profession Act 2008* (WA) s 285(1).

<sup>33</sup> For further reading relating to "contingency fees arrangement" and other fees structures, see Damian Grave and Ken Adam, *Class Actions in Australia* (2012).

<sup>34</sup> See also a report from V. Morabito, "Litigation Funders, Competing Class Actions, Opt Out Rates, Victorian Class Actions and Class Representatives", Australian Research Council, September 2010 (Second report)

In the majority of the shareholder class action cases, the claims have been typically about investment losses. Shareholders claimed that the company and its directors and officers had engaged in activities that constituted a breach of the misleading or deceptive conduct provisions under the *Corporations Act* 2001 (C'th). Directors and officers of the company had provided inaccurate or incomplete financial statements,<sup>35</sup> and/or the company had failed to comply with the continuous disclosure obligations.<sup>36</sup>

A *King v GIO Australia Holdings Limited (2000)*

*King v GIO Australia Holdings Limited*<sup>37</sup> was the first shareholder class action in Australia. This case had no third party litigation funding. King was a shareholder of GIO Australia Holdings Limited ("the company"). He engaged a law firm to assist on a "no win no fee" basis and launched a class action against the company and its former board of directors in August 1999.<sup>38</sup>

The claim was that in 1998, in an attempt to defend a hostile takeover from AMP Limited, the board of directors of GIO Australia had negligently or through misleading or deceptive conduct, issued a number of statements to its shareholders urging them not to sell their GIO shares to AMP Limited that offered a price of \$5.35 per share. Many of the GIO shareholders took notice and kept their shares. Six months later, GIO Australia suffered a loss of \$2 billion and its' share price dropped to \$2.75 per share.

The class action began in August 1999 with a small pool of group members. It was estimated that about 67,000 shareholders were entitled to participate in the class action,<sup>39</sup> many of whom were small individual investors. By 2001, the same law firm originally engaged by King represented about 22,000 GIO shareholders. Furthermore, about 18,000 shareholders had formally filed a notice in court to opt out of the proceedings.<sup>40</sup> The remainder of the GIO

<sup>35</sup> Relevant provisions are ss.670A, 953A, 1022A, 1041E, 1041F, 1041H, 1308 and 1309 of the *Corporations Act* 2001 (C'th); and s.12DA of the *Australian Securities and Investments Commission Act* 2001 (C'th)

<sup>36</sup> Chapter 6-6D of the *Corporations Act* 2001 (C'th) covers continuous disclosure obligations. ASX also has Listing Rules that apply to all listed companies, including rules on compliance with continuous disclosures.

<sup>37</sup> *King v GIO Australia Holdings Limited* (2000) 174 ALR 715 at 725, 100 FCR 209 at 222-223, [2000] FCA 1543 at [7]; *King v AG Australia Holdings Ltd (formerly GIO Australia Holdings Ltd)* [2003] FCA 980

<sup>38</sup> "No-win no-fee" means if the outcome of the case is successful, then the law firm may charge a time-based rate increased by a multiplication factor or an agreed additional amount permitted under the relevant *Legal Profession Act*. The plaintiff may request the final charged amount to be reviewed by a taxing master from the relevant court if the amount appears overly excessive.

<sup>39</sup> *King v AG Australia Holdings Ltd (formerly GIO Australia Holdings Ltd)* [2003] FCA 980, at para 4

<sup>40</sup> *King v AG Australia Holdings Ltd (formerly GIO Australia Holdings Ltd)* [2003] FCA 980, at para 4

shareholders did not come forward to join in with the class action nor did they opt out of the proceeding.<sup>41</sup> The defendants contested the claim. However, by August 2003 and with the approval of the court, the defendants agreed to settle and pay \$97 million in compensation to the shareholders and \$11 million in legal costs.<sup>42</sup> It was held by the court that all eligible shareholders, who had not opted out of the class action, were entitled to be compensated and the sum of their entitlement was based on the size of their share ownership.

In this case, there was no confusion over the use of s.33J. There was no need for the court to try to interpret s.33J. It was clear that shareholders could choose to opt out of the class action and could freely do so by putting in a notice to the court with their clear intention to opt out.

#### B *Dorajay Pty Ltd v. Aristocrat Leisure Ltd (2003)*

*Dorajay Pty Ltd v. Aristocrat Leisure Ltd* (“Dorajay”) was the first commercially funded shareholder class action.<sup>43</sup> This case commenced in 2003 with the support of a commercial litigation funder, IMF (Australia) Limited.<sup>44</sup> There were 556 shareholders who signed the funding agreement and about 2,331 other shareholders who did not sign the agreement. Again, the claim was about misleading or deceptive statements on the balance sheets in that the company and its board of directors had overstated the profits, and as such the shareholders had incurred a loss when they bought shares from the company.

In an attempt to strike out the case, the defendant focused its argument on s.33J and argued that the use of a litigation funder as a way for the plaintiff to represent only the funded group members was not permitted under s.33J. The defendant argued that by requiring group members to sign the funding agreement, the funder had created a situation where 556 shareholders had “opted into” the class action and this, the defendant argued was inconsistent with the opt out mechanism in s.33J.

As noted in the above, this was the first shareholder class action case in Australia funded by a commercial litigation funder. Previously, there was a common law rule prohibiting this type of funding, known as the rule against maintenance and champerty. This common law prohibited an improper encouragement of litigation and prohibited an improper payment or receipt of a share of the win in exchange for the maintenance of a court action.<sup>45</sup> The

<sup>41</sup> *King v AG Australia Holdings Ltd (formerly GIO Australia Holdings Ltd)* [2003] FCA 980, at para 6

<sup>42</sup> *King v AG Australia Holdings Ltd (formerly GIO Australia Holdings Ltd)* [2003] FCA 1420

<sup>43</sup> *Dorajay Pty Ltd v. Aristocrat Leisure Ltd* (2005) 147 FCR 394

<sup>44</sup> IMF (Australia) Limited was a company listed in Australia that had no relation to the International Monetary Fund. The company is now known as IMF Bentham Limited.

<sup>45</sup> See the judgment of Gummow, Hayne and Crennan JJ in *Campbells Cash & Carry Pty Ltd v Fostif Pty Ltd* [2006] HCA 41; (2006) 229 CLR 386 for a discussion of the development of the doctrines.

court in *Dorajay* was called upon for the first time to determine the scope and purpose of s.33J, whether the idea of third party litigation funding would contravene the common law rule against maintenance and champerty to the point of rendering s.33J inoperable.

In the preliminary hearing in 2005, Stone J of the Federal Court was against the idea of commercial litigation funding. Her Honour noted that the legislature had “made a clear choice” for an “opt out” class action.<sup>46</sup> Stone J stated:<sup>47</sup>

I find that the requirement that group members opt in to the proceeding to be inconsistent with the terms and policy of Part IVA. It is inappropriate that the proceeding continue under Part IVA while the criterion is part of the description of the representative group. I also find that, in the way in which the criterion subverts the opt out process, it is an abuse of the court's processes as established by Part IVA.

However in 2008 and similar to the earlier case in *King v. GIO Australia*, the defendant in the present case also agreed to settle and pay \$144.5 million in compensation. The amount was approved by Stone J with a condition that all shareholders, regardless of whether they had signed the funding agreement, were entitled to participate in the share of the compensation equally. That is, both the funded group members and non-funded group members were to be treated equally in their claims for compensation. To ensure that the non-funded group members were able to participate in the recovery plan, the court ordered Maurice Blackburn, solicitors acting for the funded group, to send notices to all individual non-funded members to inform them of the proposed settlement. They were given a chance to submit their proof of claim to be considered by the court, by the date for which the court then closed the group for settlement.<sup>48</sup>

An important point to note in this case was that Stone J concluded that all group members should be given the *same* opportunity to opt out of the class action under s.33J regardless of whether they were from the funded group or non-funded group, and if they chose not to opt out, then they would *all* be entitled to receive a share of the win under the current class action regime, regardless of whether they had participated in the group proceeding.

### C *Dawson Nominees Pty Ltd v. Multiplex Ltd* (2007)

The courts in *Dawson Nominees Pty Ltd v. Multiplex Ltd*<sup>49</sup> (“*Multiplex*”) had produced a different conclusion. Both the original court and the appellate

<sup>46</sup> *Dorajay Pty Ltd v. Aristocrat Leisure Ltd* (2005) 147 FCR 394, at 429 (Stone J)

<sup>47</sup> *Dorajay Pty Ltd v. Aristocrat Leisure Ltd* (2005) 147 FCR 394, at 431 (Stone J)

<sup>48</sup> *Dorajay Pty Ltd v. Aristocrat Leisure Limited* (2008) 67 ACSR 569

<sup>49</sup> *P Dawson Nominees Pty Ltd v. Multiplex Ltd* [2007] FCA 1061; affirmed [2007] FCAFC 200

court took a different approach in dealing with the opt-out mechanism. Both courts formed the view that the procedure in Part IVA, particularly under s.33C, permitted a class action to be structured with a *closed* group, and members in this closed group could still opt out of the class proceedings under s.33J. Being a commercially funded shareholder class action, the courts noted that it might be financially unattractive for the funded group members to opt out but it was not impossible.

This case was about misleading or deceptive conduct on the part of Multiplex Ltd (the “company”) and its directors. Briefly, the company entered into a contract to build a stadium. Problems started to appear when there was a delay in the completion of the work. As a result of the long delay, the final costs of the construction exceeded the original estimate, and the company also suffered a massive drop in profit and share value. Dawson Nominees, one of the shareholders of the company, sought to recover its losses by claiming that the company had failed to disclose the extent of the cost increase and had failed to inform of the long delay in the construction.<sup>50</sup>

A law firm (“MBC”) independently investigated the strength of the claims and decided that shareholders had a strong chance of success in court proceedings. MBC then went onto the radio and encouraged other Multiplex shareholders to come forward to commence a class action. Dawson Nominees agreed to be the representative plaintiff in the class action. The facts revealed that shareholders had to sign two separate agreements to commence a class action; first the MBC’s solicitors’ retainer agreement and second, the litigation funding agreement with International Litigation Fund (“ILF”). Both agreements had similar terms, with the effect that the financial arrangement would be terminated if a group member: (a) terminated any of the two agreements; or (b) settled the claim individually and personally with the defendant; or (c) filed a notice in court to opt out of the class action under s.33J. In addition, a group member who decided to terminate the funding arrangement would have to reimburse all necessary legal costs and expenses and pay an agreed portion of the net recovery if any as commission.

In an attempt to strike out the class action, the company argued in defence that the MBC/ILF scheme was contrary to Part IVA, in that group members had no opportunity to opt out under s.33J. The defendant relied on the decision in *Dorajay* for support.

In the first instance, Finkelstein J rejected the defendant’s argument and held that there was nothing in the two agreements that would prevent the

<sup>50</sup> Breaches of the misleading or deceptive conduct were raised under s.674 and s.1041H(1) of the *Corporations Act* 2001 (C’th), under s.12DA(1) of the *Australian Securities and Investments Commission Act* 2001 (C’th) and under the old s.52 of the then *Trade Practices Act* 1974 (C’th). The latter has now been brought forward to s.18 of the *Consumer and Competition Act* 2010 (C’th) with substantially identical terms.

funded group members from opting out under s.33J.<sup>51</sup> It was held that the funded group members could opt out at anytime under s.33J and that it was not for the court to consider whether it was financially viable for them to opt out. Further, group members were not required to pay any amount upfront under the agreements, and thus it would be unlikely to see any of them wanting to withdraw from the class action.<sup>52</sup>

In his interpretation of s.33C(1), Finkelstein J. formed the view that it was possible to structure a class action with group membership limiting to “a subset of all possible plaintiffs”.<sup>53</sup> His Honour went on to say that “the only persons excluded from the group [were] free riders” and this was not inconsistent with Part IVA.<sup>54</sup> His Honour stated that the ability to limit the group size was from the last part of the sentence in s.33C(1) which in part stated that “a proceeding may be commenced by one or more of those persons as representing some or all of them”.<sup>55</sup> There are three reasons to explain why the class action must have a limit in the membership size: (1) limiting the group would provide each group member an incentive to contribute to the class action; (2) limiting the group to a manageable level would help to make the class action easier to settle; and (3) limiting the group would enable each group member a greater prospect of receiving a higher percentage of compensation when all costs and expenses had been accounted for.<sup>56</sup>

Finkelstein J was critical of the decision in *Dorajay*, saying:<sup>57</sup>

The judge took a narrower view and held that the criterion was bad simply because it required a person to opt into the group proceeding. The problem with this approach is that the judge found the [law firm] criterion amounts to an illegitimate opt in procedure without really analysing why it was an opt in procedure ... She did not say how her analysis was consistent with Parliament’s rejection of the [A]LRC’s recommendation that class actions should be brought on behalf of all affected persons.

On appeal, the Full Federal Court unanimously sided with Finkelstein J and dismissed the defendant’s argument.<sup>58</sup> Both Lindgren and Jacobson JJ spent much of their time analysing the scope of s.33C and its connection with other provisions in Part IVA. Lindgren J noted that s.33C permitted class proceedings to be brought on behalf of “some or all” of the potential group

<sup>51</sup> *P Dawson Nominees Pty Ltd v. Multiplex Ltd* [2007] FCA 1061, at para 38

<sup>52</sup> *P Dawson Nominees Pty Ltd v. Multiplex Ltd* [2007] FCA 1061, at para 52

<sup>53</sup> *P Dawson Nominees Pty Ltd v. Multiplex Ltd* [2007] FCA 1061, at para 17

<sup>54</sup> *P Dawson Nominees Pty Ltd v. Multiplex Ltd* [2007] FCA 1061, at para 48

<sup>55</sup> *P Dawson Nominees Pty Ltd v. Multiplex Ltd* [2007] FCA 1061, at para 15, and 39

<sup>56</sup> *P Dawson Nominees Pty Ltd v. Multiplex Ltd* [2007] FCA 1061, para 48

<sup>57</sup> *P Dawson Nominees Pty Ltd v. Multiplex Ltd* [2007] FCA 1061, at para 62

<sup>58</sup> *Multiplex Funds Management Limited v. Dawson Nominees Pty Ltd* [2007] FCAFC 200, (French, Lindgren and Jacobson JJ)



members.<sup>59</sup> Jacobson J made a similar comment and concluded that s.33C permitted the plaintiff “to commence a proceeding on behalf of less than all of the potential members of the group”.<sup>60</sup> On the point of opting out, all justices formed the view that the funding agreement could not have prevented the shareholders from opting out; group members could still opt out of the class action at anytime under s.33J.<sup>61</sup>

The Full Federal Court however rejected Finkelstein J’s criticism of the decision in *Dorajay* and concluded that the case was “correctly decided”<sup>62</sup> as the facts in that case were “distinguishable”.<sup>63</sup>

Similar to the previous class actions, the defendant agreed to settle and pay \$110 million in compensation to the shareholders.

The importance of the *Multiplex* decision may be summed up as follows. First, the decision in *Dorajay* is still good law, in the sense that group members can still exercise their right to opt out of the class action under s.33J. However, when a litigation funder is involved, then according to the courts’ reasoning in *Multiplex*, it may be possible for a class action to be structured in a way where members are within a “closed” group and these members in the “closed” group can opt out under s.33J. In effect, it may be possible for a “closed” group of claimants to exclude other potential claimants who have not signed the litigation funding agreement. Second, it may be possible for several class actions to be running simultaneously, with members from different “closed” groups signing litigation funding agreements with different funders. The overall effect of the decision in *Multiplex* is to exclude free riders from participating in the receipt of benefits from the successful class action.

#### D Kirby v. Centro Properties Limited (No.6) (2012)

*Kirby v. Centro Properties Limited (No.6)* was another commercially funded shareholder class action case.<sup>64</sup> It appears that the court was no longer concerned with the purpose and application of the opt out provision in s.33J. The court in this case had essentially adopted the *Multiplex* approach and did not see s.33J as an issue where a litigation funder was involved. That is, given

<sup>59</sup> *Multiplex Funds Management Limited v. Dawson Nominees Pty Ltd* [2007] FCAFC 200 (per Lindgren J) para 5, 10 and 11. Examples of provisions that could provide a broad construction of s.33C were ss.33D, 33E, 33F, 33G and 33N.

<sup>60</sup> *Multiplex Funds Management Limited v. Dawson Nominees Pty Ltd* [2007] FCAFC 200, (per Jacobson J), at para 111

<sup>61</sup> *Multiplex Funds Management Limited v. Dawson Nominees Pty Ltd* [2007] FCAFC 200, at para 146 and 150 (per Jacobson J, with whom French and Lindgren JJ agreed)

<sup>62</sup> *Multiplex Funds Management Limited v. Dawson Nominees Pty Ltd* [2007] FCAFC 200, at para 171 (per Jacobson J)

<sup>63</sup> *Multiplex Funds Management Limited v. Dawson Nominees Pty Ltd* [2007] FCAFC 200, at para 143 (per Jacobson J)

<sup>64</sup> *Kirby v. Centro Properties Limited (No.6)* [2012] FCA 650

the growing acceptance of the role of commercial litigation funding in shareholder class actions, the interpretation of s.33J has become “less important”.

This case involved two separate class actions run by two different law firms. There were about 6000 shareholders in the two cases, with one law firm, Slater and Gordon, representing 5000 individual shareholders and the second law firm, Maurice Blackburn, representing 1000 other retailer shareholders. IMF Limited<sup>65</sup> was the provider of litigation funding for the class action run by the second law firm.

In short, shareholders claimed that they had suffered investment losses because of the alleged breaches of the reporting obligations by Centro Properties Group. They claimed that there were significant errors in the auditing report, that a short-term debt was wrongly classified as a long-term debt, and that a number of company guarantees had not been included in the audit. Both cases commenced about the same time. Given the common claims in both cases, the court found it convenient to join these two class actions into one.

Half way through the trial and with the approval of the court, the defendant agreed to settle the claims with a payout figure of \$200 million, which is still the largest settlement sum in Australia for a shareholder class action. Group members who had registered with either of the two law firms were entitled to a share of the settlement.

In this case, there was no dispute over the wording of the opt-out provision in s.33J. It seemed that after the *Multiplex* decision, the court had simply accepted that a commercially funded class action had become common practice in Australia. There was no lengthy discussion on how difficult or easy for group members to opt out of the proceedings under s.33J.

Justice Middleton of the Federal Court was somewhat pleased to see an end to this class action. His Honour noted that if the case were to continue, the final decision would hinge “on difficult and controversial points of law and appeals would be inevitable”.<sup>66</sup> He added that, “such a process brings greater uncertainty to recovery, and would involve substantial delay even if liability were to be established.”<sup>67</sup> From that statement, one could say that the court was concerned with the lack of clarity in the class action procedure. This in effect could lead to greater uncertainty for group members if the case were to continue.

<sup>65</sup> IMF Limited was a company that had no relationship to the International Monetary Fund.

<sup>66</sup> *Kirby v. Centro Properties Limited (No.6)* [2012] FCA 650, para 4

<sup>67</sup> *Kirby v. Centro Properties Limited (No.6)* [2012] FCA 650, para 4

E *Modtech Engineering Pty Limited v GPT Management Holdings Limited*  
(2013)

Another case worth mentioning is *Modtech Engineering Pty Limited v GPT Management Holdings Limited* (“GPT Management”),<sup>68</sup> where 92% of the shareholders had signed both the litigation funding agreement and the lawyers’ retainer agreement and 8% had not signed any agreement. Instead, those 8% of the shareholders were free riders. A term in the funding agreement stated that the litigation funder would receive a commission of 25-30% from the net recoveries after all litigation costs had been reimbursed. An interesting point to note in this case is that the court appeared not to follow the decision in *Multiplex*, instead the approach in the present case was quite similar to the approach taken in *Dorajay*.

The grounds for a class action were similar to those raised in the earlier cases. Shareholders claimed they had suffered investment losses because the defendant, GPT Management Holdings, had misled them into believing that the company was financially profitable and the defendant had failed to comply with the continuous disclosure obligations under the legislation.

At the end of the hearing and before a final judgment was handed down, the defendant however agreed to settle the claims. One of the terms in the settlement proposal, prepared by the litigation funder, was that the funder’s commission be deducted from the amounts received by all shareholders, including those 8% of the shareholders who did not sign the funding agreement but had benefited from the class action. Gordon J rejected that term in the proposal on the basis that the litigation funder had made a commercial decision to fund the class action with only 92% of the shareholders, and thus it would not be fair on the 8% of the shareholders to pay 25-30% of the commission when they had not entered into any agreement.<sup>69</sup>

It was clear that the court was prepared to allow the 8% of the free riders to benefit from the class action. However, to ensure that the 8% of the non-funded shareholders would not receive more compensation than the 92% of the funded shareholders, Gordon J decided that the commission, which would have been deducted and paid to the commercial litigation funder under the settlement proposal, would be pooled and distributed on a pro rata basis to all class shareholders.<sup>70</sup> The court approved the settlement sum of \$75 million, which was to cover the shareholders’ entitlements and the litigation funder’s

<sup>68</sup> *Modtech Engineering Pty Limited v GPT Management Holdings Limited* [2013] FCA 626; and *Modtech Engineering Pty Limited v GPT Management Holdings Limited* [2013] FCA 1163

<sup>69</sup> *Modtech Engineering Pty Limited v GPT Management Holdings Limited* [2013] FCA 626, at para 57

<sup>70</sup> *Modtech Engineering Pty Limited v GPT Management Holdings Limited* [2013] FCA 626, at para 58. This method, known as the “equalisation factor”, has been used in a number of class action settlements.

commission. As for the lawyers' costs, the court approved the sum of \$8.5 million as audited by the court's registrar.<sup>71</sup>

The important difference between the present case and *Multiplex* is this. In *Multiplex*, the court unanimously adopted the "closed" class approach and *excluded* the free riders from participating in the recovery process. However, the court in *GPT Management* took a more liberal approach and treated all shareholders equally. The court in *GPT Management* seemed to favour the approach in *Dorajay* and allowed all shareholders to participate equally in the share of the compensation, irrespective of whether they had opted into the funding arrangement.

#### F What can be learnt from these shareholder class actions?

There are two major issues arising from these commercially funded shareholder class actions.

##### 1 The "lock in" effect in a commercially funded class action

There are arguments for and against commercial litigation funding.<sup>72</sup> However, what is clear is that litigation funding has changed the characteristics of the "opt out" provision, to the point where the provision now has multiple interpretations. In the literal sense, s.33J provides group members with an opportunity to opt out of the class action if they do not wish to be bound by the decision of the court. However, as seen in the above cases and with the growing acceptance by the courts of the role of litigation funders, shareholders do not always have the choice of opting out of the class action because of the high costs imposed by the funder if they do decide to opt out. There is no real opportunity for them to opt out when they have signed the funding agreement. If they choose to opt out as permitted by s.33J, they are to repay the litigation funder the amount they owe under the contract and such amount may include penalties, interests, and the like and the total amount could even be higher than the actual costs of the proceedings. In effect, many group members are locked into the class action when they choose to opt into the funding arrangement. In short, when a litigation funder is involved in the class action, s.33J is ineffective as a tool for opting out. There is no real choice for group members to opt out.

##### 2 Inconsistency in the decisions between *Dorajay* and *Multiplex*

In *Dorajay*, unless members had elected to opt out of the class action as permitted under s.33J, it was clear to the court that under Part IVA all group

<sup>71</sup> *Modtech Engineering Pty Limited v GPT Management Holdings Limited* [2013] FCA 1163

<sup>72</sup> See report from Productivity Commission, *Inquiry Report on Access to Justice Arrangements*, Volume 2, Final Report No 72, 5 September 2014, Canberra, Recommendation 18.2 at page 633. This Report was released for public viewing on 3<sup>rd</sup> December 2014.

members were entitled to make a claim for a share of the win, regardless of whether they were from the funded or non-funded groups.

In *Multiplex*, both the original and the appellate courts provided a different interpretation to the class action procedure and to the opt out mechanism under s.33J. In *Multiplex*, it was possible for a class action to be structured in ways that the plaintiff would be representing either “some or all” of the group members. Since the plaintiff was in the funded group, the courts decided that the plaintiff was representing only those members who were also funded and were in the funded group, which the outcome was that the non-funded shareholders were not entitled to participate in the recovery scheme and were excluded from the class action. Both the original and the appellant courts in *Multiplex* formed the view that s.33C enabled the plaintiff to represent “some or all” of the group members and held that these funded group members being represented could opt out of the class action at any time under s.33J. It might be financially unattractive for them to opt out but it was not impossible.

Clearly, there is inconsistency in the decisions between *Dorajay* and *Multiplex*. The recent development of the commercial litigation funding industry has altered the scope of the opt out mechanism in s.33J. While the litigation funding arrangement in *Multiplex* only allowed members to join into that group *before* the commencement of the class action and those members could later opt out of the proceedings; the group membership in *Dorajay* could change anytime *until* the settlement date. In other words, the *Multiplex* decision excluded the free riders while the *Dorajay* decision welcomed the free riders to join the class action at anytime up until the court closed the case for settlement. In line with the *Dorajay* approach, the court in *GPT Management* did not exclude the non-funded members from an entitlement to compensation.

This inconsistency may be best resolved through legislative intervention. The question to be considered is whether there is any point in retaining the current wording in s.33J given that group members are not free to opt out of the funded class action and that the court could exclude some group members from the class action. It may be fair to say for now that the opt out model continues to apply under the current class action legislation in Australia, but because of the Full Federal Court decision in *Multiplex*, it is possible to structure a class definition as a closed class under limited circumstances.

## V IS REFORM NECESSARY?

The view of the author is that the class action procedure in Part IVA of the FCAA is in need of reform. Below explains the reasons.

### A Lack of clarity in the term “opt out”

First, the opt out provision referred to in s.33J is ambiguous. Section 33J(2)

states very simply that a “group member may opt out of the representative proceeding by written notice given under the Rules of Court before the date so fixed”. Without further information to clarify the scope or the intent, the provision could lead to multiple interpretations.

One interpretation is that *all* group members who have not opted out of the class action as permitted by s.33J are entitled to make a claim for a share of the net recovery if there is a successful outcome in the class action. The difficulty with this interpretation is when a class action is commercially funded, there is likely to be two groups of members – the funded group and the non-funded group. The funded group members are those who have signed the funding agreement as a way of showing their support for the class action. The non-funded group members are essentially the free riders. The uncertainty in s.33J relates to the issue of free riders, whether it is the intent of the legislature to exclude them (or not) from the class action. The difficulty is considering whether the non-funded group members should be given a free ride at the expense of the funded group members who have signed the funding agreement and have shown support for the class action. There is no provision in Part IVA of the FCAA to assist in the understanding of the logic behind the wording of s.33J. Section 33J does not make a distinction between the funded group members and non-funded group members.

Another interpretation may be illustrated by considering the conflicting outcomes in *Dorajay* and in *Multiplex*. In *Dorajay*, unless group members had decided to opt out, all groups members were entitled to a share of the compensation in the commercially funded class action regardless of whether they were from the funded or non-funded group; and this approach was favoured by a subsequent case in *GPT Management*. In *Multiplex*, it was made clear that the free riders would be excluded from receiving any benefit in the commercially funded class action. This is translated to mean that if they chose not to opt into the funding arrangement then they would be removed from the recovery process and would have no chance of deciding whether to opt out of the class action.

The lack of clarity in the opt-out provision in s.33J may be explained further by comparing the two judgments of Finkelstein J in shareholder class action cases. In 2005 in an unreported case of *Cadence Asset Management Pty Ltd v. Concept Sports Limited*,<sup>73</sup> Finkelstein J declined to allow the class action to continue. His view was that both the litigation funding agreement and the lawyers’ retainer agreement had created an “opt in” mechanism. His Honour concluded that this practice was inconsistent with the “opt out” mechanism under s.33J, in that group members were not given an opportunity to opt out.

<sup>73</sup> *Cadence Asset Management Pty Ltd v. Concept Sports Limited* (unreported, Federal Court of Australia, Finkelstein J, decision 23 December 2005). The case was settled out of court in October 2006.

However, two years later in 2007 in the case of *Multiplex*, Finkelstein J changed his view and permitted the commercially funded class action to continue, saying that “the action would probably not have gotten off the ground” if there were no litigation funder involved.<sup>74</sup> The change of view by Finkelstein J could be because of the 2006 decision in *Fostif*, where the High Court had approved a commercially funded retailer class action for the first time in history.

### B Defendant under pressure to settle

The second reason for the need to improve the class action procedure relates to the premature settlement of the class action, that the defendant is often under pressure to settle the class action before a full hearing or before a final court judgment. Currently there are far too many class action cases aborted half way into the court hearing, with the defendant elected to settle and pay compensation.<sup>75</sup> This is not to say that the defendant in a class action has no case to answer, but rather the defendant has no choice but to go for an approved out of court settlement as this is its only best solution under a difficult situation.

Indeed, the reality is that any form of litigation is an unwanted distraction; it takes away the defendant’s time and resources from dealing with the more important day-to-day business. Protracted litigation could further jeopardise the defendant’s reputation and goodwill in its business. There are other factors adding further pressure on the defendant to settle the class action prematurely. The defendant is well aware that the main objective of a commercial litigation funder is to make money from funding the class action and so the funder would go to any length to ensure a successful outcome in the class action, including appealing to a higher court if necessary. The defendant also knows that in an opt out class action, if the case continues long enough, the prospect of the class size becoming larger is inevitable, as more group members will hear about the case in the news and will decide to participate in the recovery process, making it more expensive for the defendant to settle all the claims.

At the same time, the litigation funder is also aware of the defendant’s weaknesses, and the funder would use these weaknesses as a strategic weapon to force a settlement upon the defendant. In an overall scheme of things, it would be a cheaper option for the defendant to agree to a settlement without admitting liabilities. The reality is when shareholders engage a litigation funder to fund the class action, the defendant has no way out but to agree to the terms of settlement. In this instance, there is no justice for the defendant. One way of addressing this problem would be to amend the class action procedure, so that

<sup>74</sup> Dawson Nominees Pty Ltd v. Multiplex Ltd [2007] FCA 1061, at para 34

<sup>75</sup> See V. Morabito, “*Litigation Funders, Competing Class Actions, Opt Out Rates, Victorian Class Actions and Class Representatives*”, Australian Research Council, September 2010 (Second report)

the defence case can then be brought forward for a full court hearing. The other approach would be to set a maximum fee that a litigation funder can charge when funding a class action.

C *Commercially funded class action is only for the benefit of lawyers and litigation funders*

A number of authors have commented that the current class action model is designed for the benefit of lawyers of the representative plaintiff and the litigation funder.<sup>76</sup> One author observed that there is an “economic incentive” for the law firm to get the litigation funder involved in the class action.<sup>77</sup> Group members who are entitled to receive compensation from a successful class action tend to receive very little benefit from the case. Much of the recovery goes to the lawyers acting on behalf of the group members and to the litigation funder for helping to fund the class action. In practice, group members are only entitled to a pro rata amount, which in real term if their shareholding in the company is relatively small and the pool of participating shareholders is large, the amount they will receive will be insignificant. The other problem with the current class action model is that the representative plaintiff has no right of a greater amount of recovery than the other members in the group. One member in the group may have initiated a class action, but there is no financial reward for taking the lead. The current model does not reflect how group members are to be compensated or how they are to achieve a fair outcome.

## VI CONCLUSION

This article has highlighted some difficulties with the operation of the “opt out” provision under s.33J. An Australian class action with an “opt out” mechanism can easily be turned into an “opt in” class action when a litigation funder is involved. It appears there is an inconsistency in the application of the opt-out provision. In some cases, the courts had allowed all group members, both funded and non-funded members, to participate in the recovery process unless the members have chosen to opt out of the class proceeding. By contrast, in the case of *Multiplex*, the court had excluded non-funded group members known as free-riders from receiving any benefit in the successful shareholder class action.

<sup>76</sup> See, for example, S. Clark and C. Harris, “The push to reform class action procedure in Australia: Evolution or revolution?” (2008) 32 *Melbourne University Law Review* 775; V. Morabito, “Class actions instituted only for the benefit of the clients of the class representative’s solicitors” (2007) 29 *Sydney Law Review*, 5, at 1 and 38

<sup>77</sup> Cashman, P, “Class action on behalf of the clients: Is this permissible?” (2006) 80 *Australian Law Journal* 738, at 752



In addition, currently, the entities that benefit most from the class proceeding are the litigation funder and the group members' legal representative, while individual group members receive only a small percentage of the recovery and if their shareholding in the company is small the pro rata amount of their recovery may be insignificant.

Due to the widespread use of commercial litigation funding as a way to commence a class action and given that the High Court has approved such practice, perhaps now is the time for the legislature to address the anomalies in the class action provisions in Part IVA of the FCAA. It is the view of the author that the only way for a commercially funded class action to be working effectively would be to revise and amend the class action procedure, making room to accommodate the role of commercial litigation funding.