From multiplicity to causation – What's new in class actions in financial lines

Class actions are now an established part of Australia's litigation landscape. They have been available in the Federal Court since 4 March 1992, in Victoria since January 2000 and in New South Wales since March 2011. The Australian Government supports class actions (and litigation funders) as it sees that they provide access to justice for a large number of consumers who would otherwise have difficulty in having their claims heard and assessed.[1] On the other hand, directors see class actions brought against corporations as highly complex pieces of litigation that have the potential to impose significant burdens on the companies and directors involved.[2] This concern does not arise because of the number of class actions – an average of only fourteen class actions are currently filed every year in the Federal Court – but because of their scale. Typically a class action will involve difficult legal and factual issues and take up significant amounts of director and executive time. It may be for this reason that many class actions are ultimately settled. As Finkelstein J of the Federal Court (as he then was) said:

> 'Perhaps more than most cases, class actions lend themselves to compromise because of the uncertainty of their result, difficulties of proof, complexities in the assessment of damages as well as the expense of a long trial'.[3]

Class actions arise in a number of different contexts from claims about defective products to claims about employee discrimination. In this paper, we focus on developments in class actions relating to financial lines, including class actions brought by shareholders or holders of other securities or by investors in various financial products. These developments include the rise of a multiplicity of actions, often raising the same or similar allegations and involving the same defendants. Linked to this is the fact that regulators, especially the Australian Securities and Investments Commission (**ASIC**), are more willing to use their powers to commence proceedings in the form of class actions, especially in relation to the collapse of certain financial service providers following the GFC. A rare judgment last year in a class action, in a case against the promoters of an agribusiness investment scheme, highlighted the importance of causation and provided some useful guidance on issues of disclosure. Finally, we consider the use of the Financial Ombudsman Service by some groups of plaintiffs as an alternative to a class action.

Multiplicity of actions

There are a number of examples of recent corporate collapses which have led to a number of different class actions. One reason for this is the involvement of litigation funders. Each of the statutory class action schemes are based on an opt out system. That is, unless a member of the class takes positive steps to remove themselves from the class, they will be bound by whatever judgment is made or settlement is reached. However the way that the class is defined can have the effect of limiting the group members. Where a litigation funder is involved, the definition of the group may include a requirement that each group member has entered into an agreement with that litigation funder. These restrictions in effect close the class. Even though such restrictions have the effect of requiring group members to take a positive step to opt in to the proceedings, contrary to the opt out nature of the statutory class action regime, they have been found to be effective.[4] The collapse of the Centro Securities

---

[1] Explanatory commentary on draft Corporations Amendment Regulations to exclude class actions from managed investment schemes www.treasury.gov.au

[2] Australian Institute of Company Directors submission on the draft regulations.

[3] *P Dawson Nominees Pty Ltd v Brookfield Multiplex Ltd (No 4)* [2010] FCA 1029

[4] *Mulitplex Funds Management Ltd v P Dawson Nominees Pty Ltd* [2007] FCAFC 200.

group has given rise to six separate proceedings with three separate groups of class members. Two of those groups are 'closed classes' where the members have had to opt in by signing an agreement with a litigation funder while the third is an open class and includes all investors who have not signed a litigation funding agreement with that entity. The claims essentially relate to the same factual circumstances and give rise to the same legal issues and are being heard together.

Also, in addition to class actions commenced by individual representative plaintiffs, ASIC has the power to bring representative proceedings on behalf of injured parties[5], and has become more active in doing so. Since November 2007, ASIC has launched nineteen civil actions seeking to recover funds for investors in companies in the Westpoint Group (including a claim against KPMG, the former auditors of the Westpoint Group, claims against the directors of various Westpoint companies and claims against financial planners who advised their clients to invest in Westpoint). A number of these actions have been settled. Similarly, ASIC has commenced two separate proceedings seeking compensation on behalf of investors arising out of the collapse of Storm Financial Limited, one against Bank of Queensland Limited, Senrac Pty Limited and Macquarie Bank Limited alleging breach of contract, unconscionable conduct and liability as linked credit providers of Storm under the *Trade Practices Act* 1974 and the second against the Commonwealth Bank of Australia Limited, Bank of Queensland Limited and Macquarie Bank Limited alleging that the conduct of the Storm model amounted to the operation of an unregistered managed investment scheme. In addition, two separate class actions have been commenced by individual representative plaintiffs following the collapse of Storm.

While a multiplicity of class actions can complicate the conduct of the defence and increase costs, it also has an impact on the public resources of the judicial system. As a result, the courts have tended to take a practical approach to the way that a number of class actions dealing with essentially the same subject matter are conducted. Sometimes the cases proceed side by side listed before the same judge with joint directions hearings and sometimes interlocutory matters may be heard separately but the matters will be listed for hearing together or one after the other. In one example, Federal Court class action proceedings commenced in Sydney were transferred to Melbourne so that they could proceed in tandem with another class action in the court there, as both related to alleged breaches of continuous disclosure obligations against the same company. However joint management is not always appropriate, or may cease to be appropriate, and in those matters the separate proceedings will proceed separately.

The involvement of regulators

Another important aspect of the involvement of ASIC is its power to gather evidence. These powers are very wide and once the documents are gathered together, they can be subpoenaed in a class action by a plaintiff who seeks to benefit from the information in them. In many cases where this happens, ASIC will not object to the subpoena and will produce the documents for inspection.

Recent examples include *Mercedes Holdings Pty Limited v Waters (No. 4)*[6], a class action brought in the Federal Court against a number of entities and persons formerly involved in the MFS Premium Income Fund (**the Fund**). Put simply, the applicants in the class action alleged that the trustee of the Fund entered into arrangements with MS Pacific Finance Limited under which the Fund participated, improvidently, in six loans for $62.5 million, and that the respondents had breached various duties in relation to the transactions. The applicants had obtained possession of a pleading filed by ASIC in separate proceedings in the Supreme Court of Queensland against a number of entities and people involved in the Fund prior to its collapse. ASIC was not a party to the Federal court class action. As the judge in the Federal Court commented, the statement of claim in the Queensland Court put a very different perspective on the transactions, alleging not that they were improvident (as alleged in the class action) but that they never occurred and were instead merely the window dressing for a conspiracy to disguise an old fashioned fraud. The applicants issued two subpoenas to ASIC seeking documents referred to in the particulars to ASIC's pleading. ASIC produced the

[5] Section 50 *Australian Securities & Investments Commission Act* 2001 (Cth)
[6] [2011] FCA 666

documents to the court but two of the respondents applied to set the subpoenas aside. The judge rejected their application, allowing the applicants access to the documents.

In *Australian Securities & Investments Commission v Storm Financial Ltd (Receivers and Managers Appointed) (in liq) (No. 4)*[7], ASIC had brought the class action and proposed to discover to the other parties in the proceedings a large number of documents that it had obtained from *Challenger Managed Investments Ltd and Challenger Ltd* (**Challenger**) using its investigative powers. Challenger was not a party to the proceedings and objected to the documents being discovered. As the judge stated:

> 'ASIC is in an unusual situation in these proceedings. It is the repository of the Challenger documents, some 27,000 in all, having obtained them by use of its investigatory powers under the *ASIC Act*. Only a small proportion, something like 141 of them, is relevant to ASIC's case against the three banks in these proceedings. A larger proportion may be relevant to the three bank's defence of ASIC's action against them, or to the applicants, or to the banks, in the two class actions that are being run in conjunction with these proceedings. ASIC has no interest in assessing whether that is so, ie whether the Challenger documents are relevant to those other proceedings. To the contrary, it does not wish to incur the expense of doing so. Even if it were ordered to, I do not think it could be expected to assess whether or not the documents may be relevant to the three banks' defence of its action against them, much less whether they may be relevant to the applicants in the class action, or the defence of those actions by the banks involved in those proceedings.'

The judge specifically rejected Challenger's argument that ASIC had a statutory duty[8] to keep the Challenger documents confidential. However he found that he should be satisfied that the documents had an apparent relevance to the issues in the proceedings and that it was necessary for those parties seeking access to the documents to persuade him of that.

Of course, the involvement of a regulator may influence a defendant in other ways. When a number of investors lost money after placing funds with two financial advisers who were representatives of AMP, for what the High Court described as its own sound commercial reasons (including the need to protect its relations with the ASIC, its license and its goodwill), AMP paid out the claims of those investors in a way that did not involve the investors establishing that AMP was in fact legally liable for the claims.[9] It would not be fanciful to suspect that this is not the only instance where a company has been encouraged by ASIC to resolve disputes with disgruntled investors.

The importance of reliance and a win for defendants

The first shareholder class action in Australia was commenced in 1999 against GIO, alleging misleading representations in connection with a takeover. That was settled in 2003 for A$112 million (including costs of $15 million). Since then a number of other class actions have been commenced by shareholders and other security holders but none has yet proceeded to judgment (although the Centro class action which is being heard at the time of writing this paper may do so). One reason may be the uncertainties surrounding the question of causation.

Typically, the claims in a securities class action will be based on allegations of misleading or deceptive conduct in respect of inaccurate or incomplete statements or a failure to disclose certain information and/or breach of a listed company's continuous disclosure obligations. In either case, even if breach is established, causation is a significant issue. That is, the plaintiff must establish that they relied on the misleading or deceptive conduct, or the false or misleading statement, or that they would have acted differently if the material fact had been disclosed. In Australia there is no established theory of 'fraud on the market' so that in a securities class action, the as yet undetermined question is whether each member of the class has to establish the appropriate reliance individually or if it is sufficient just to establish the representative plaintiff's reliance and then that of every other class member can be presumed.

Similar issues of reliance and causation also arise in other financial lines class actions, such as those against investment entities or financial advisers, which similarly usually involve allegations of misleading and deceptive conduct. A decision last year highlighted the

---

[7] [2011 FCA 1536]

[8] under section 127 of the *ASIC Act* 2001 (Cth)

[9] *CGU Insurance Limited v AMP Financial Planning Pty Limited* [2007] HCA 36.

importance of the issue, and of choosing an appropriate representative plaintiff. In *Woodcroft-Brown v Timbercorp Securities Limited (in Liq) & Ors*[10] Judd J of the Victorian Supreme Court dismissed a class action brought by investors in Timbercorp's agribusiness schemes who were seeking to avoid liability for loans entered into with Timbercorp to finance their investment in the relevant schemes.

Timbercorp Securities Limited ran a number of registered managed investment schemes relating to horticultural and forestry projects. There were a number of different product disclosure statements issued in relation to the projects. The fifth defendant, Timbercorp Finance Pty Ltd, provided finance to investors in the schemes. Despite presenting an apparently healthy financial position in its 2008 Annual Report (published at the end of December 2008), the Timbercorp group collapsed in June 2009. The plaintiff, Mr Woodcroft-Brown, had invested in various Timbercorp projects. He commenced class action proceedings on behalf of himself and others who had invested in Timbercorp projects in the period between 6 February 2007 and April 2009 alleging:

- that the product disclosure statements that were prepared by Timbercorp Securities were defective because they did not disclose information about certain risks as required by the *Corporations Act*; and
- misleading and deceptive conduct.

The plaintiff argued that had the relevant risks been disclosed and had the misleading and deceptive conduct not occurred, he would not have invested in the scheme and would not have borrowed money to do so. The relief claimed included an order that he and other members of the class action group were not liable to repay their loans from Timbercorp Finance.

The plaintiff failed.[11] The judge found that the product disclosure statements did contain the required statutory disclosure, that there was no misleading and deceptive conduct and that in any event the plaintiffs had failed to establish that the necessary reliance and causation.

His Honour followed the decision of the New South Wales Court of Appeal in *Ingot Capital Investments Pty Ltd v Macquarie Equity Capital Markets Ltd*[12] that a plaintiff relying on a contravention of the *Corporations Act* in respect of claims for misleading or deceptive conduct must establish that they relied on the misleading or deceptive conduct, or the false or misleading statement, or that they would have acted differently if the material omission had been disclosed.

In this case, on the evidence, the judge was not persuaded that Mr Woodcroft-Brown had even read any of the product disclosure statements in any detail or possibly at all before making the decision to invest and found that the content and detail of each product disclosure statement was not an actuating factor in his decision to make the investments, and so he failed to establish the requisite level of reliance.

Issues of disclosure

The judgment in the Timbercorp case contains some useful guidance to those drafting Product Disclosure Statements for managed investment schemes, and may indicate the approach that the courts will take to issues of allegedly misleading and deceptive statements in securities class actions.

The *Corporations Act* 2001 (Cth) requires that a product disclosure statement must disclose information about any significant risks associated with holding a financial product. The amount of information required is that which a person would reasonably require for the purpose of making a decision, as a retail client, whether to acquire the financial product.

The plaintiff argued that the following were significant risks that should have been disclosed in the product disclosure statements relating to the Timbercorp projects, but were not:

- a structural risk relating to the financial structure of the Group business, being a risk that the Group might fail to discharge its contractual obligations (which was

---

[10] [2011] VSC 427
[11] The Plaintiff has lodged an appeal.
[12] [2008] NSWCA 206

characterised as the performance risk) due to financial incapacity either because of insufficient cash flow should members of other schemes fail to make contributions or because the group might not be able to obtain or service external debt or because it could not access funds by securitising investor loans;

- the risks relating to certain adverse matters, the most important of which were an announcement in February 2007 of a proposal by the ATO to change its position on the deductibility of upfront fees paid by investors, the global financial crisis and the alleged near insolvency of the group in early 2008.

The plaintiff also alleged that the product disclosure statements were misleading or deceptive in that:

- they failed to disclose the adverse matters (set out above);
- they failed to disclose that the Timbercorp Group was dependent on its ability to maintain and increase its borrowings and to sell assets in a timely matter so that if capital or debt markets tightened there was a real prospect that the Group would be at risk (the financing risk);
- they contained financial representations to the effect that the Timbercorp Group was sufficiently strong that investors could reasonably expect that Timbercorp Securities would continue to manage each scheme throughout its term, and that the principal risks associated with each relevant scheme were fully disclosed.

Judd J found that the structural risk was in the nature of an institution risk, that is, a risk that the institution which operates the managed investment scheme will collapse. That risk was a significant risk and although it was an everyday risk of all commercial transactions it was nonetheless one that ought to be specifically disclosed to a retail client. He also found that the risk was in fact disclosed in the product disclosure statements.

His Honour found that Timbercorp was not required to disclose the adverse matters to potential or existing investors, as they were events that had no independent status as risks, let alone significant risks, and that the adverse matters did not make the information contained in the product disclosure statements misleading or deceptive.

The case did not concern the continuing disclosure obligations of Timbercorp, as a listed entity, under Chapter 6CA *Corporations Act*. However the Judge noted that even pursuant to those obligations, Timbercorp was not under an obligation to inform investors in the schemes of an event such as one of the adverse matters unless and until management realised that the event may not be capable of successful management so that they may not be able to avoid the crystallisation of the risk, in this case that the company might fail to discharge its contractual obligations due to financial incapacity.

As to the financing risk, the defendants established that the banks had continued to support the Group until well after the last Product Disclosure Statement was issued, and all adverse matters had occurred. Only information that is actually known, that is, of which the relevant persons have actual knowledge, must be included in a Product Disclosure Statement. The board were not aware of any risk to cash flow until December 2008 (after the issue of the last PDS), as it was not until then that continuing bank support became uncertain, so this was a complete answer to the cash flow risk case.

The financial representations to the effect that the Timbercorp Group was sufficiently strong that investors could reasonably expect that Timbercorp Securities would continue to manage each scheme throughout its term were representations about how things would be in the future (and so would not be misleading or deceptive if made on reasonable grounds). The Judge found that Timbercorp established that they had reasonable grounds for their expressions of confidence in the group's viability and strength, which consequently were not misleading or deceptive.

Financial Ombudsman Service

An Australian Financial Services Licensee who provides financial services to retail clients (primarily individuals and small businesses) must be a member of an ASIC approved external dispute resolution scheme.[13] The Financial Ombudsman Service (**FOS**) is such a scheme, probably the most commonly used one. It covers a wide variety of disputes including disputes relating to banking, credit, loans, general insurance, life insurance, financial planning, investments, stock broking, managed funds and pooled superannuation trusts.

Unless the financial services provider agrees otherwise, there are caps on the amount of compensation that FOS may award. The caps vary according to the product involved and for many types of financial product go up to $280,000 but in some cases could go as high as $500,000. Even so, these are relatively small claims. However the caps apply to each individual complainant so that a number of individuals who have the same complaint can each bring separate claims before FOS, so that a large number of investors in a particular financial product or a large number of clients of a particular financial adviser can choose to bring claims before FOS as an alternative to commencing a class action and in some cases have done so. When looked at individually, the claims are not large but when put together can amount to some millions of dollars.

As the claims usually involve allegations of misleading and deceptive conduct or failure to disclose, they have the same difficulties of proof and complexities in issues of causation and the assessment of damages as similar matters litigated in the courts. However the FOS process is very different. In contrast to the formal court process, FOS endeavours to resolve disputes by negotiation and conciliation but does have power to make determinations. These determinations are binding on the financial service provider but not on the complainant. Although not the intent of the scheme, it would be open to claimants to use the FOS process as a means of determining the scope and strength of any defence as a prelude to possible court action (but information obtained through FOS may not be used in subsequent court proceedings unless required by an appropriate court process such as discovery). Further, in making its decision FOS will do what in its opinion is fair in all the circumstances, having regard to good industry practice and applicable industry codes or guidance as to practice as well as to legal principles. As fairness is a subjective matter, this can lead to even more uncertainty about the outcome and pressure on the financial services provider to settle. However FOS has limited power to award costs which may discourage some groups from using this avenue as an alternative to a class action.

June 2012

This article was prepared by Kathryn Rigney, Director and Julia Turner, Senior Associate and was included at the Australian Updated 2012 seminar held in London on 16 May 2012. Kathryn Rigney can be contacted on 9231 7027 or at krigney@ypol.com.au and Julia Turner can be contacted on 9231 7059 or at jturner@ypol.com.au

LEVEL 2, 39 MARTIN PLACE
SYDNEY NSW 2000

DX 162 SYDNEY

T: +61 2 9231 7000
F: +61 2 9231 7005
WWW.YPOL.COM.AU

YPOL PTY LTD TRADING AS
YELDHAM PRICE O'BRIEN LUSK
ACN 109 710 698

[13] Section 912A *Corporations Act* 2001 (Cth)