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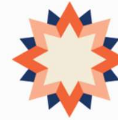

RULE OF LAW
INSTITUTE OF AUSTRALIA

REPORT ON CLASS ACTIONS

September 2020

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Plaintiff law firms offer three main arguments when seeking to play down the negative economic impact of anti-business class actions:[1]

i) They compensate victims of corporate misconduct

ii) They ensure companies do not profit from misconduct

iii) They benefit companies that do not engage in misconduct

In theory, these factors might seem persuasive. But problems are apparent once the real world impact of shareholder class actions is assessed against this framework.

There are certainly benefits associated with compensating those who have suffered losses at the hands of corporate wrongdoers. The consolidation of similar claims has the potential to save the time of the courts and provide access to justice for claimants who would otherwise be unable to justify the expense of civil action. In practice, however that admirable goal has been corrupted.

Some settlements fall well short of the value of the damage caused by wrongdoers - sometimes by 40 per cent. Transaction costs such as lawyers' fees and litigation funders' commissions further reduce the amount available for distribution, sometimes consuming two thirds of what is left. Shareholders are then presented with compensation that amounts to a fraction of the value of their losses.

It needs to be clearly understood that there is nothing objectionable in the fact that lawyers and litigation funders are paid for their services. But when the Australian Law Reform Commission considered this issue in 2018 it found that the median return to shareholders from class actions in the Federal Court was just 51 per cent after the deduction of legal fees and commission to litigation funders.

After examining shareholder class actions finalised in the Federal Court between 2013 and 2018 the commission found that the lowest return to group members was 29 per cent of the settlement, the highest proportion spent on legal fees was 50 per cent and the highest commission rate was 33 per cent.[2]

Those who resist the need for reform can take no comfort from those findings. They show the utility of shareholder class actions as a system of compensation is waning. Any system of compensation that costs more to run than it delivers in benefits cannot withstand the case for change.

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[1] Maurice Blackburn Lawyers, submission to the federal parliamentary Joint Committee on Corporations and Financial Services' inquiry into litigation funding and the Regulation of the Class Action Industry, paragraph 7.28

[2] Australian Law Reform Commission, Integrity, Fairness and Efficiency - An Inquiry into Class Action Proceedings and Third-Party Litigation Funding, December 2018, page 85

The ALRC's report confirms that this is exactly what is happening in a significant number of shareholder class actions.

The current system has degenerated to the point where it sometimes provides greater benefits for service providers than it does for those who employ them. The fact that this is happening in a minority of cases is irrelevant. It should never happen.

In shareholder cases outlined in this report, some of which were finalised after the ALRC study, transaction costs have taken much more than half of the settlement.

> *"In defence of disproportionate transaction costs it is sometimes said that without the lawyers and funders no compensation would be possible. But our civil justice system cannot be said to be operating effectively if the only way to obtain compensation is to have half of it chewed up in the friction of adversarial litigation."*[3]

Collateral damage

There is, however, an even greater problem. Far from conferring benefits on companies that do not engage in misconduct, collateral damage associated with these claims is being inflicted on third parties. Innocent companies are being forced to pay substantially more for insurance because Australia is now viewed as having a high level of litigation risk[4] due to a class action system that favours plaintiffs[5].

According to the US Chamber Institute for Legal Reform:

> *"Australia's class action regime is more plaintiff friendly than that of the United States . . . As a consequence, class actions can, and are, run in Australia in relation to issues which could not be the subject of class action proceedings in the United States."*[6]

The broader economy is also paying a price. The cost of settlements in shareholder class actions is eventually paid by corporate insurance cover. Insurance broker Marsh says that since 2011, the

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[3] Professor Michael Legg, University of NSW, submission to the Parliamentary Joint Committee on Corporations and Financial Services' inquiry into Litigation Funding and the Regulation of the Class Action Industry, page 2

[4] Marsh insurance brokers, submission to the Parliamentary Joint Committee on Corporations and Financial Services' inquiry into Litigation Funding and the Regulation of the Class Action Industry, pages 4 and 6

Marsh's submission, citing a 2017 assessment by law firm Allens, says: "Australia has now become the most likely jurisdiction outside the United States in which a corporation may face significant securities class action."

[5] US Chamber Institute for Legal Reform, submission to the Parliamentary Joint Committee on Corporations and Financial Services' inquiry into Litigation Funding and the Regulation of the Class Action Industry, pages 2 and 3

[6] US Chamber Institute for Legal Reform, ibid

number of insurers serving the Australian market for directors' and officers' insurance has decreased after insurers contributed more than $1 billion to settlements involving listed companies.

The average increase in premium for the ASX200 in 2019 was 118 per cent "with extreme cases at a staggering 600 per cent; and there are no signs of these increases slowing . . . insurers are now so concerned about the potential size and scope of securities class actions that many are either cutting back their offering or no longer writing the coverage at all."[7]

> *"The list of insurers that have withdrawn from providing D&O insurance to ASX listed companies includes WR Berkley, AAI Ltd trading as Vero Insurance (part of the Suncorp Group), Allianz, Talbot Australia and Lloyd's of London syndicates Novae, Neon, Canopius, Pioneer, Axis and Acapella. Other insurers including AXAXL, Zurich, Chubb and Liberty in addition to Underwriting Agencies, Dual Australia and London Australia Underwriting have reassessed their exposures and have become more discriminating about purchasers to whom they will offer D&O coverage. In some cases, the restrictions imposed are so onerous that they amount to a de facto withdrawal."*[8]

Marsh has warned that companies are also being subjected to increased "retentions" - which is the amount they are required to pay, in the event of a claim, before drawing on their insurance. For listed companies, retentions are now typically $10 million to $50 million with extreme cases reaching about $225 million.

This encourages companies to quarantine capital to cover possible future liabilities. At a time when taxpayers are paying billions of dollars in subsidies to save jobs, the litigation risk caused by shareholder class actions is encouraging companies to set aside capital that would otherwise be available to provide goods and services that create employment.

Uncompensated losses

The argument that shareholder class actions prevent companies from profiting from their wrongdoing also appears to overstate the effect of these claims. Research by Professor Michael Legg has found[9] that settlements in several of these matters have fallen well short of the losses estimated by aggrieved shareholders and securities holders. If the ability to avoid paying compensation is an improper benefit to the wrongdoer, shareholder class actions are only partly effective in preventing companies from benefiting from wrongdoing. The corporate regulator, the Australian Securities and Investments Commission, does take proceedings against corporate wrongdoers. But the level of

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[7] Marsh, ibid, page 2

[8] Marsh, ibid, page 2

[9] Professor Michael Legg, Securities Regulation in Australia, contained in Enforcement of Corporate and Securities Law, edited by Robin Hui Huang and Nicholas Calcina Howson, Cambridge University Press, page 317

unrecovered losses - and the collateral damage being inflicted on innocent parties - must raise doubts about the efficacy of class actions as a system of private enforcement of corporate law.

When the settlement in the GIO class action[10] was being approved by the court, Justice Michael Moore observed that the best present estimate of the loss suffered by group members was about $151 million. Because $97 million compensation was to be paid, the judge said individual group members would receive about 60 per cent of the loss they had suffered. That appears to mean the settlement left the company with a notional benefit from its wrongdoing that would have been equivalent to 40 per cent of the total loss - or $60.4 million.

In the Multiplex case,[11] which also features in Legg's research, the settlement amounted to about $110 million. Justice Ray Finkelstein observed that class members would recover about 62 cents on the dollar of the reasonable value of their claims. That appears to mean the aggrieved plaintiffs had been deprived of compensation for 38 per cent of what their lawyers, Maurice Blackburn, had estimated to be the reasonable value of their claim.

The judge said the settlement in the Multiplex case was "a significant recovery" - and compared to the settlement in a subsequent class action, that is certainly the case.

In the Oz Minerals settlement,[12] Legg relates how Justice Arthur Emmett said the total settlement sum of $60 million was equivalent to just 32 per cent of the $185 million value of the claims if they had been completely successful.

The relatively low settlements in these cases, when compared to the losses claimed, raise more doubts about the efficacy of shareholder and securities class actions. Because these cases generally result in a settlement, rather than a decision by a court, they can lead to wrongdoers providing a relatively limited amount of compensation. The reduction in legal costs associated with settlements means this can be in the interests of plaintiffs. But the point remains that as a system of compensation, class actions are unlikely to return shareholders to the position they enjoyed before the breach by the wrongdoer.

Private enforcement

Private enforcement of the law through class actions also ensures that enforcement is influenced by the economic interests of private players - plaintiff law firms and litigation funders - instead of being determined by the objective degree of wrongdoing. This has been highlighted by the Australian Law Reform Commission:

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[10] King v AG Australia Holdings Ltd (formerly GIO Australia Holdings Ltd) [2003] FCA 980 at 14

[11] P. Dawson Nominees Pty Ltd v Brookfield Multiplex Limited (No 4) (2010) FCA 1029, paragraph 22

[12] Hobbs Anderson Investments Pty Ltd v Oz Minerals Ltd [2011] FCA 801 at paragraph 15

The preponderance of class actions that are filed in the Federal Court are heavily skewed towards shareholder and investor disputes, which are low risk and profitable to run. The ALRC has heard in consultations that there are many cases with reasonable prospects of success that are not run because they are deemed by funders and lawyers not to be economic.[13]

Two other factors help explain the popularity of this form of civil claim. The first is that the main corporate regulator, the Australian Securities and Investments Commission, encourages shareholder class actions using arguments that are are almost identical to those of the leading class action law firms.

The second and most important factor is that the law that lies at the heart of most of these claims is out of step with international practice, favours plaintiffs and - according to a leading commercial law firm - has a structure that makes it very difficult, if not impossible, for companies to ensure compliance.

Most shareholder and securities class actions are based on allegations that listed companies have breached a provision of the Corporations Act that requires them to immediately disclose market-sensitive information[14]. In Australia, this is a strict liability offence in which liability arises without the need for a fault element such as negligence or dishonesty. This is not the case with equivalent provisions in Britain and the United States where liability will only arise if the company or its officers engaged in misleading conduct or misbehaviour.[15]

The Australian Institute of Company Directors has provided the Parliamentary Joint Committee on Corporations and Financial Services with a comparative analysis of the different continuous disclosure regimes. That document, prepared by law firm Herbert Smith Freehills, outlines the impact the strict liability regime is having on Australian companies:

"From the perspective of Australian listed entities, it is very difficult, if not impossible, to ensure ongoing comprehensive compliance with the continuous disclosure regime. Combined with Australia's relatively facilitative class action law, this creates a constant risk for listed companies that a class action can be brought by plaintiff lawyers representing a class of shareholders whenever there is a significant decline in

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[13] Australian Law Reform Commission, Integrity, Fairness and Efficiency - An Inquiry into Class Action Proceedings and Third-Party Litigation Funding, December 2018, paragraph 8.9

[14] This continuous disclosure obligation is outlined in Listing Rule 3.1 of the Australian Securities Exchange, which has been given statutory force by section 674 of the Corporations Act.

Listing Rule 3.1 says: "*Once an entity is or becomes aware of any information concerning it that a reasonable person would expect to have a material effect on the price or value of the entity's securities, the entity must immediately tell ASX that information.*"

[15] Australian Institute of Company Directors, submission to the Parliamentary Joint Committee on Corporations and Financial Services' inquiry into Litigation Funding and the Regulation of the Class Action Industry, page 4

share price. The relatively easy allegation is that the class has suffered loss as a result of a delay in disclosure of a material development in breach of the continuous disclosure rule."[16]

The Parliamentary Joint Committee is examining the factors driving the increased prevalence of class actions[17] and is due to report on December 7, 2020. But the economic dislocation caused by the onset of the coronavirus pandemic has already prompted the federal government to temporarily ease the strict liability element of the continuous disclosure obligation.

In late May, Treasurer Josh Frydenberg issued the Corporations (Coronavirus Economic Response) Determination (No 2) which temporarily brought the test for liability for continuous disclosure breaches closer to the approach used in Britain and the US. The goal was to ease the litigation risk to business during the pandemic. Until November, when the determination expires, strict liability will be replaced with a system that means liability will only be imposed if a breach arose with the knowledge of the company concerned or was due to recklessness or negligence.[18]

The requirement for class action lawyers to prove recklessness or negligence has not removed the obligation on listed companies to continuously disclose market-sensitive information. Yet Maurice Blackburn, one of the leaders in class action litigation, believes the change is a "precipitous and unjustified watering down of Australia's continuous disclosure regime"[19] that should certainly not be permanent.

The Australian Securities Exchange, which is the entity primarily responsible for developing and monitoring continuous disclosure obligations, takes the opposite view:

"We don't see the steps taken to date as inconsistent with strong and effective continuous disclosure rules and the maintenance of market integrity. . .

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[16] Herbert Smith Freehills, Comparative analysis of international corporate disclosure and liability regimes, June 2018, page 1, included in the AICD's submission to the Parliamentary Joint Committee on Corporations and Financial Services inquiry into Litigation Funding and the Regulation of the Class Action Industry

[17] Point 8 in the terms of reference which requires the inquiry to examine the "factors driving the increasing prevalence of class action proceedings".

Other parts of the terms of reference ask the inquiry to examine what evidence is becoming available with respect to the present and potential future impact of class actions on the economy; and the potential impact of Australia's class action industry on vulnerable Australian business already suffering the impacts of the COVID-19 pandemic

[18] The temporary amendment does not affect misleading and deceptive conduct laws - which are also a common feature in shareholder class actions.

[19] Maurice Blackburn Lawyers, submission to the federal parliamentary Joint Committee on Corporations and Financial Services' inquiry into Litigation Funding and the Regulation of the Class Action Industry, paragraph 7.2

We also welcomed and supported the steps taken by the government in May to introduce a fault element to the continuous disclosure provisions in the act, and we've said that that reform has not changed the way we monitor and enforce our continuous disclosure rules."[20]

This does not seem inconsistent with the view of the Australian Securities and Investments Commission that continuous disclosure obligations are "critical to the integrity and reputation of Australia's capital markets".[21]

Despite Frydenberg's goal of easing the litigation risk confronting listed companies, ASIC has a record of encouraging aggrieved shareholders to approach law firms to run class actions backed by litigation funders. This is not apparent from ASIC's submission to the Parliamentary Joint Committee. It says ASIC made statements in its submission to the Australian Law Reform Commission's 2018 inquiry into class actions and litigation funders and "We do not seek to repeat those here . . .".[22]

ASIC is authorised to run representative actions to recover losses for individuals,[23] but it told the ALRC it encouraged aggrieved shareholders to deal with class action law firms and litigation funders so ASIC can allocate its resources elsewhere:

"Where <u>private action can achieve a similar outcome to that which action by ASIC could achieve</u>, it allows ASIC to allocate its regulatory resources to other priorities. ASIC encourages investors to consider private legal action where appropriate to obtain compensation for losses investors may have suffered . . .

"<u>Often, the only practical means for shareholders to enforce their rights is through a funded shareholder class action</u>, as individual losses are too small to justify pursuing individually. . . .

"In addition to promoting access to justice, class actions can spread the risks of complex litigation and <u>improve the efficiency of litigation by introducing commercial considerations that may reduce costs.</u>"[24] *[Emphasis aded]*

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[20] Daniel Moran, general counsel and company secretary of the Australian Securities Exchange, evidence to the Joint Parliamentary Committee's inquiry, July 29, 2020, Hansard, page 29

[21] ASIC submission to the Australian Law Reform Commission, 2018, paragraph 24

[22] ASIC submission to the federal parliamentary Joint Committee on Corporations and Financial Services' inquiry into Litigation Funding and the Regulation of the Class Action Industry, page 3

[23] ASIC Information Sheet 151, ASIC's Approach to Enforcement, says at page 6:

"We have powers under s50 of the ASIC Act to begin a representative action to recover damages or property for persons who have suffered loss. We will ordinarily only take action to recover damages or property on a person's behalf if this would be in the public interest, beyond the interests of the affected consumers. <u>We encourage investors to consider alternative options to recover damages or property from wrongdoers where possible, such as by lodging a dispute with the Financial Ombudsman Service or taking private legal action</u>." (Emphasis added)

[24] ASIC submission to the Australian Law Reform Commission inquiry into class action proceedings and third party litigation funders, September 2018, page 11

ASIC's endorsement of funded shareholder class actions has clearly been influenced by the desire to offload some of its enforcement responsibilities to the private sector.[25] It justifies this approach by pointing to what it believes is the efficiency of class actions. In at least some matters it believes private litigation can achieve a similar outcome to that which ASIC could achieve.

Yet as the cases outlined above indicate, the efficiency as class actions is open to question both as a system of compensation and as a method of ensuring corporate wrongdoers do not benefit from their misconduct. ASIC's argument is in line with the assessment of leading class action firm Maurice Blackburn:

"Shareholder class actions complement action by ASIC to enforce Australia's continuous disclosure regime, thereby promoting the integrity of Australia's financial markets . . . The role of class actions in these contexts is important because Australian regulators are not adequately resourced to investigate or prosecute all breaches of the law and their focus is on prosecutorial activity not on ensuring compensation to victims."[26]

There are several problems here:

▪ The first problem is that the Australian Securities Exchange takes a less positive view than ASIC about the role of class actions as a method of enforcing this requirement. The ASX believes this form of litigation may disproportionately benefit litigation funders rather than the shareholders who have suffered losses due to breaches of this obligation:

"From ASX's perspective, the key point is that timely and effective enforcement of Australia's continuous disclosure framework rests on ASX's actions in monitoring and enforcing compliance with its continuous disclosure rules and on ASIC's actions in enforcing the continuous disclosure provisions in the Corporations Act, and not on civil damages proceedings . . .

"Securities class actions can be seen as supplementing regulatory enforcement of continuous disclosure. This may have a positive impact on the governance of listed entities and the accountability of their directors and senior management, promoting greater transparency and better investor outcomes over time. . .

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[25] Data assembled by the AICD and presented to the Joint Parliamentary Committee indicates there is room for ASIC to do more about enforcing this area of law.

In the past five years, the AICD says

- at page 11 of its submission to the committee - that ASIC's enforcement reports show its activity on continuous disclosure consisted of:

Five civil matters

Two criminal matters

One enforceable undertaking

Sixteen administrative remedies (infringement notices)

[26] Maurice Blackburn Lawyers, ibid, paragraph 7.23

"However, we would comment that the contribution of securities class actions to enforcement outcomes would be impacted by the timeliness of those proceedings, which often take many years to resolve, and the tendency of those proceedings to settle rather than proceed to judgement. [Emphasis added]

"We would also comment that it appears that the benefit of securities class actions may disproportionately benefit litigation funders rather than plaintiffs in those proceedings, with the costs falling on the shareholders of the listed entity."[27] *[Emphasis added]*

▪ The second problem is ASIC's belief that in at least some cases enforcement of continuous disclosure using class actions financed by commercial litigation funders can achieve a similar outcome to public enforcement by the corporate regulator.

From ASIC's perspective, that might be true - if the ASX's concern about the delays inherent in class actions is put to one side. But from the perspective of aggrieved shareholders who must bear the transaction costs associated with funded class actions significant differences emerge. The use of class actions to police continuous disclosure has cost aggrieved shareholders hundreds of millions of dollars.

In its submission to the parliamentary class actions inquiry, the Law Council of Australia included details of 13 class action settlements[28] that had been assembled by the class actions committee of the Law Council's federal litigation section. Of the nine claims lodged on behalf of shareholders total settlements amounted to $796.1 million. Legal costs and commission paid to litigation funders amounted to $275.6 million or 34.6 per cent of total settlements. Funders received a total of $185.2 million or 23.3 per cent of the settlements while legal fees amounted to $90.4 million or 11.4 per cent.

The consumer law committee of the Law Council's legal practice section conducted a separate exercise in which it provided details of 71 class action settlements including 22 finalised shareholder claims.[29] Total settlements in the 22 matters amounted to $840.4 million. In two cases the funders' commission was unknown. If those two cases are excluded, settlements in the 20 remaining shareholder matters amounted to $737.9 million and funders received commission of $171.7 million. Once again, this amounted to 23.3 per cent of total settlements while legal fees in this larger sample amounted to $148.5 million or 20.1 per cent.

[27] Daniel Moran, group general counsel and company secretary of the Australian Securities Exchange, submission to the federal Parliamentary Joint Committee on Corporations and Financial Services' inquiry into Litigation Funding and the Regulation of the Class Action industry, page 2

[28] Law Council of Australia, submission to the Parliamentary Joint Committee on Corporations and Financial Services, Attachment A

[29] Law Council of Australia, submission to the Parliamentary Joint Committee on Corporations and Financial Services, Attachment B

These figures are averages and in some of the cases cited by the Law Council, the transaction costs were much higher, consuming up to two thirds of settlements:

▪ In Guglielmin v Trescowthick (No 5) [2006] FCA 1385, an unfunded class action, legal fees came to $1.55 million or 52 per cent of the $3 million settlement.

▪ In the Adidas class action[30] legal fees and the funder's commission took $19.2 million or 59.2 per cent of the $32.4 million settlement. Legal fees came to $10.8 million (33.3 per cent) while the funder's commission was $8.4 million (25.9 per cent).

▪ In Santa Trade Concerns Pty Ltd v Robinson (No 2) [2018] FCA 1491 legal fees and the funder's commission took $2 million or 66.7 per cent of the $3 million settlement. Legal fees came to $1.5 million (50 per cent) while the funder's commission came to $500,000 (16.7 per cent).

▪ In HFPS Pty Ltd (Trustee) v Tamaya Resources Ltd (in liquidation) (No 3) [2017] FCA 650 legal fees and the funder's commission took $4.62 million or 68.4 per cent of the $6.75 million settlement. Legal fees came to $3.42 million (51 per cent) while the funder's commission came to $1.2 million (17 per cent).

▪ In Caason Investments Pty Ltd v Cao (No 2) [2018] FCA 527 legal fees and the funder's commission took $13.2 million or 68.8 per cent of the $19.2 million settlement. Legal fees came to $7.5 million (39 per cent) while the funder's commission came to $5.7 million (30 per cent).

The way ahead

There is clear evidence about the limitations of shareholder and securities class actions as a system of compensation and as a system of regulation. Private enforcement of the continuous disclosure obligation has also given rise to concern that this system serves the interests of litigation funders and class action law firms. The AICD believes securities class actions "are now about maximising returns for for-profit entities, rather than facilitating access to justice for shareholders".

Responsibility for that situation does not rest with law firms and litigation funders. They are responding rationally to the law underpinning continuous disclosure that is considered to be pro-plaintiff and a low-risk option for enterprising lawyers. Law firms and funders might benefit from this law, but blaming them would be futile and counter-productive. The real problem is the law - which is at odds with the approach taken in comparable jurisdictions that are just as committed to keeping markets informed.

Responsibility for the law rests with successive federal governments that introduced this scheme and retained it despite concern about its effect. In 2018, the Australian Law Reform Commission issued a discussion paper that referred to the "peculiar characteristics" of the law underpinning

[30] Inabu Pty Ltd as trustee for the Adidas Superannuation Fund v CIMIC Group Ltd [2020] FCA 510

shareholder class actions and called for a review of the legal and economic impact of Australia's method of using class actions to enforce continuous disclosure:

> *". . . there is growing evidence of unintended adverse consequences caused by the existing framework of the Australian class action regime, coupled with the peculiar characteristics of the Australian statutory provisions concerning continuous disclosure obligations (as compared with some other cognate common law jurisdictions) and those relating to misleading and deceptive conduct."*[31]

If shareholder class actions are to remain a credible part of the civil justice system, they need reform based on two principles:

i) The purpose of this form of civil action is to compensate those who have suffered a wrong. This system will face an uncertain future unless it is clearly seen to be operating primarily for the benefit of aggrieved shareholders, not lawyers and financiers.

ii) Collateral damage to innocent third partries should be minimised. This requires more action to address the litigation risk confronting listed companies in order to head off the incipient capital strike by the insurance industry.

Before the intervention of treasurer Josh Frydenberg, the US Chamber Institute for Legal Reform had declared Australia's class action regime to be uniquely plaintiff friendly and one of the "most onerous continuous disclosure private enforcement regimes in the world".[32]

That flaw has been addressed, at least temporarily, by an amendment that retains the substantive obligation to keep the market continuously informed but brings the law closer to that of comparable jurisdictions. With no end in sight for the pandemic, and the economy in recession, now is not the time to increase pressure on business. The logical next step would be an extension of Frydenberg's temporary change. This would enable policy makers to take up the ALRC's suggestion and focus on the legal and economic impact of continuous disclosure - which lies at the heart of shareholder class actions - and determine whether the changes need to go further.

According to law firm Ashurst,[33] it is far from clear that the negligence requirement that has been imposed provides any practical barrier to claims that would otherwise have been brought. That firm also points out that the changes do not apply to misleading and deceptive conduct laws, which are also generally invoked during shareholder class actions.

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[31] Australian Law Reform Commission, discussion paper for the commission's Inquiry into Class Action Proceedings and Third-Party Litigation Funders, June, 2018, paragraph 1.73 and proposal 1-1

[32] US Chamber Institute for Legal Reform, submission to the Parliamentary Joint Committee on Corporations and Financial Services' inquiry into Litigation Funding and the Regulation of the Class Action Industry, page 2

[33] Ashurst, submission to the Parliamentary Joint Committee on Corporations and Financial Services' inquiry into Litigation Funding and the Regulation of the Class Action Industry, paragraph 20

The ASX is confident that the change does not weaken the law. If it is extended, at least for the duration of the pandemic, it could help persuade the insurance industry that Australia is serious about easing the litigation risk confronting business. Failing to extend Frydenberg's changes after they expire in November would have the opposite effect, affirming the wisdom of those insurers that have reduced their exposure to this country and encouraging others to follow their lead. That would amount to a self-inflicted wound.

Ashurst has suggested that consideration should also be given to introducing a "due diligence defence" for companies that take reasonable steps to ensure they comply with their obligations or formed a reasonable judgment in good faith.[34]

This would go beyond s.674(2B) of the Corporations Act which provides a defence for persons involved in a company's contravention. That provsion does not apply to companies nor to breaches of other legislation that may be the subject of a class action.

Another option would be the AICD's proposal to abandon private enforcement of continuous disclosure and require ASIC to step up its enforcement of this part of the Corporations Act.[35] This would require better resourcing for the corporate regulator and the possible addition of a special division that would run representative proceedings seeking compensation for shareholders.

Public enforcement of corporate law gives companies confidence that enforcement decisions are based on the public interest rather than which cases would be the most profitable.

> *"One such mechanism could be to enable ASIC to seek compensation on behalf of affected shareholders. This could include, where a company is found to have breached the continuous disclosure rules and ordered to pay damages, facilitating a compensation mechanism that affected shareholders could then claim against. The benefits of such a mechanism is that it would maximise returns to class members by reducing litigation fees, as well as costs of competing claims."*[36]

Michael Legg has argued that class actions seek to maximise the welfare of the private enforcer which may differ from social welfare. He writes that litigation will be commenced whenever the private benefit of that litigation exceeds its costs. The private enforcer is not concerned with or accountable for the impact of its actions on social welfare. Public regulation, by contrast, can calibrate its response depending on the facts and circumstances of a particular case. He describes private enforcement as "a wedge driven into the side of the enforcement pyramid . . . Regulated

[34] Ashurst, ibid, paragraph 19

[35] AICD, ibid

[36] AICD, ibid, page 12

entities may have no incentive to negotiate or cooperate with a regulator as substantial damages claims may still follow".[37]

Even if law makers are not inclined to give ASIC a broad monopoly on enforcing continuous disclosure, there would still be significant benefits in giving ASIC a monopoly limited to major cases and adequate resources to undertake that work. This would give the regulator the ability to head off the risk of multiple class actions over major incidents. It could ensure compensation in major cases would not be unduly eroded by transaction costs and, on Legg's argument, it would enable social welfare to be considered when enforcing the continuous disclosure obligation.

Chris Merritt
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[37] Legg, ibid, page 330