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Australian Shareholders Rejoice: Current Developments in Australian Corporate Litigation

By Paul Von Nessen *

I. Introduction

Recent cases in the United States and Australia have provided dramatic evidence of opposing trends in the two countries in regard to shareholder litigation. In 2007 the United States Supreme Court case of Tellabs, Inc. v. Makor Issues & Rights Ltd.1 ("Tellabs") illustrated the difficulty which United States plaintiffs now face in meeting the threshold requirement for securities class actions, that of pleading with sufficient particularity the scienter of the defendants to the action. In the same year, the Australian High Court approved, in Campbells Cash and Carry Pty. Ltd. v. Fostif2 ("Fostif"), the use of funding arrangements for speculative litigation while encouraging shareholder claims in relation to defective disclosure documents and failure of continuous disclosure. The Australian High Court did this by allowing such claims to rank equally with those of other creditors in Sons of Gwalia Ltd. v. Margaritic3 ("Sons of Gwalia"). These decisions, close on the heels of the first steps toward elimination of historic inhibitors of shareholder actions by the Australian Federal Court in the Concept Sports case in 2005,4 will likely result in

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significant shareholder litigation in Australia, just as such actions are being effectively constrained in the United States.

In the United States, the securities class action was an extremely popular proceeding, enabling shareholders to seek redress for a number of varied complaints against corporations and their management. Prospectus failures, continuous disclosure failures and corporate governance deficiencies could all potentially lead to actions by a group of shareholders with severe consequences for the corporation and individual directors. Misuse of these actions eventually led to Congressional intervention to prevent the worst abuses of class actions in their application to corporate and securities regulation. Tellabs confirms that the new constraints, requiring potential litigants to plead both the facts alleging securities fraud as well as the facts evidencing the defendant’s intention to deceive, manipulate and defraud, are particularly effective.

On the other hand, shareholder litigation in Australia has historically faced a number of impediments arising from the Australian adherence to legal principles which originated in the United Kingdom, often retaining such legal concepts long after they were abandoned in the United Kingdom itself. Because certain features of the Australian legal system (found in much of the common law world aside from the United States) are not conducive to speculative lawsuits, these actions have not, until now, been frequently used in Australia. Although tort reform in Australia, as


6. See Cox, supra note 5, at 499.

7. This is merely another in the progression of legislation and interpretive cases to indicate that the higher pleading requirements are effective. See Owen Pell & Kamari Nelson, Supreme Court Raises Bar for Pleading Securities Fraud Claims, 26(8) BANKING & FIN. SERVICES POL’Y REP. 12 (2007); Kevin O’Riorden, Clear Support or Cause for Suspicion? A Critique of Collective Scienter in Securities Litigation, 91 MINN. L. REV. 1596 (2007).

8. For consideration of the upside for Australian class actions, see Stuart Clark, Thinking Locally, Suing Globally: The International Frontiers of Mass Tort Litigation in Australia, 74 DEF. COUNS. J 139 (2007).

9. For background on Australian Class Actions, see Vince Morabito, An
Australian Shareholders Rejoice in the United States,\textsuperscript{11} has had an impact upon the possible use of the class action, reducing both its attractiveness and usefulness for such things as consumer litigation, the judicial developments in corporate law may now mean that class actions in relation to corporate securities are certain to be the new growth area in Australian litigation.

This article briefly reviews the class action procedures in both the United States and Australia. It considers the abuses which have led to legislation in the United States addressing the misuse of class actions particularly in relation to corporate securities which underpin the \textit{Tellabs} decision. The article then considers the three recent judicial decisions (\textit{Concept Sports}, \textit{Sons of Gwalia}, and \textit{Fostif}) which will encourage shareholder litigation (including class actions) in Australia in future years.

\section*{II. Shareholder Litigation: The Procedural Difficulties}

Before considering the ability of shareholders to seek redress for harms done to them individually, it is important to consider the likely difficulties of such litigation. For injuries in relation to fraud or other misleading conduct which has resulted in the issuance, purchase or retention of shares, the individual plaintiff shareholder, acting alone, would be pursuing claims against a corporate entity which, if still solvent, is likely to face similar claims from other shareholders once the plaintiff shareholder proves successful. The disparity between the two parties (one being potentially liable to numerous parties for the same action, the other seeking redress for themselves alone) presents a perfect argument for the use of class actions, a procedure by which a number of damage claims can be aggregated procedurally. Outside of the United States, class actions are a relatively novel concept, with most common law countries following the United Kingdom representative action model. In such representative action, a plaintiff may act as the representative of a group of plaintiffs so long as they

\begin{footnotesize}

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share a common interest and a common grievance, and the relief sought is in its nature beneficial to all who are represented. Due to the way these actions developed in the common law outside of the United States, discussed below, they are better designed for declaratory relief than damage actions, for the factors which lead to the attribution and assessment of damages may differ markedly from plaintiff to plaintiff.

In the event that the defendant company is insolvent, plaintiff shareholders face the prospect of pursuing claims in insolvency or bankruptcy in competition with the claims of creditors. In such a case the success of the claim is likely to be greatly reduced (or eliminated entirely) depending upon whether the shareholder is considered a creditor claimant, entitling them to participate equally with all creditors, or a claimant deferred to the claims of general creditors because they are deemed to be properly dealt with as equity contributors whose equity is required to absorb the losses of the firm so that creditors may be paid. With claims arising from deceitful or misleading share transactions, the policy argument on the proper treatment of such claims varies from country to country.

III. Class Actions and Their Control - The United States Experience

A. The Historic Evolution

The antecedents of the class action that evolved in the United States can be found in the English common law, which was faced with the difficulty of determining the rights of a multitude of parties, some of whom were unable to be joined in the action. Since it is a principle of common law justice that those who are not parties to a

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legal action should not be bound by any purported determination of their rights; therefore, certain matters would not be possible to resolve in the absence of particular parties to the dispute.

The English Courts of Chancery evolved methods for dealing with such contingencies in the seventeenth and eighteenth century. The Bill of Peace was used in order to resolve disputes with a group presenting common issues, such as property disputes.\textsuperscript{15} Other examples of actions with a multitude of potential litigants that were permitted by the Courts of Chancery included creditor claims against a debtor’s estate, legatees’ claims against a testamentary estate, and disputes concerning unincorporated associations. These actions, involving representatives of those with common rights or burdens, enabled the resolution of the common issues presented without the necessary participation of all parties. While initially absent parties were not bound by such decisions, eventually a number of decisions affirmed that absent parties could be bound by a determination so as to avoid a multiplicity of litigation. These procedures originally developed unsystematically. However, when the common law and equity courts were merged in England in 1873, the new rules of procedure attached as a schedule to the Supreme Court of Judicature Act 1873 (Eng.),\textsuperscript{16} and adopted the chancery practice (addressed in greater detail in the section dealing with Australian class actions, below). Lord Macnaghten, in \textit{Duke of Bedford v. Ellis},\textsuperscript{17} summarized the policy objectives of the rule in the following terms:

The old rule in the Court of Chancery was very simple and perfectly well understood. Under the old practice the Court required the presence of all parties interested in the matter in suit, in order that a final end might be made of the controversy. But when the parties were so numerous that you never could ‘come at justice,’ to use an expression in one of the older cases, if everybody interested was made a party, the rule was not allowed to stand in the way. It was originally a rule of convenience; for the sake of convenience it was relaxed.\textsuperscript{18}

Similar issues as those faced in the English Courts were also being addressed in the United States, and the practice of the English

\begin{itemize}
\item \textsuperscript{15} Zechariah Chafee, \textit{Bills of Peace with Multiple Parties}, 45 \textit{Harv. L. Rev.} 1297 (1932).
\item \textsuperscript{16} Supreme Court of Judicature Act, 1873, 36 & 37 Vic., c. 66. (Eng.).
\item \textsuperscript{17} Duke of Bedford v. Ellis, [1901] A.C. 1.
\item \textsuperscript{18} \textit{Id.} at 8.
\end{itemize}
Chancery Court found resonance with Justice Joseph Story in his authoritative text on pleadings in equity. In this treatise, Justice Story indicated that all persons materially interested in the subject matter of a suit should be joined as parties. He further indicated, however, that where the parties were so numerous as to make it impractical to join all the parties, joinder could be dispensed with if it could be done without injury to the persons not actually before the court. The evolution of multi-party litigation in the United States Federal Equity Courts proceeded in somewhat contradictory ways through the development of the common law (e.g., Smith v. Swormstedt and Supreme Tribe of Ben-Hur v. Cauble) and through the promulgation of procedural rules, which allowed for such actions.

The principles applying to class actions in the United States did not achieve precise clarification despite the work of commentators in the late nineteenth and early twentieth centuries. As in England, the procedures which developed in the Courts of Equity to deal with class actions were normally allowed for Courts which were newly able to exercise both law and equity jurisdiction. The procedures adopted in 1938 for the United States federal courts upon this event were largely based upon the work of Justice Story. Reflective of the

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19. JOSEPH STORY, COMMENTARIES ON EQUITY PLEADINGS (1838).
22. These contradictory developments are discussed in Hazard, Gedid & Sowle, supra note 14, at 1897-1902. While Swormstedt and Ben-Hur indicated that the decree in the case would be binding upon all in the class represented including those who were absent (Swormstedt, 57 U.S. at 302), Rule 48 of the Federal Equity Rules of 1842 stated:
   Where the parties on either side are very numerous, and can not, without manifest inconvenience and oppressive delays in the suit, be all brought before it, the Court in its discretion may dispense with making all of them parties, and may proceed in the suit, having sufficient parties before it to represent all the adverse interest of the plaintiffs and defendants in the suit properly before it. But, in such cases, the decree shall be without prejudice to the rights and claims of all the absent parties.
   Hazard, Gedid, & Sowle, supra note 14, at 232.
23. JOHN NORTON POMEROY, TREATISE ON EQUITY JURISPRUDENCE (1881); THOMAS A. STREET, FEDERAL EQUITY PRACTICE (1909). A discussion of their attempts at synthesis of class action jurisprudence can be found in Hazard, Gedid & Sowle, supra note 14, at 1917-1923.
classification developed by Justice Story, the Federal Rules of Civil Procedure ("Federal Rules") adopted in 1938 provided for three categories of class actions:

1. true class actions, which were suits involving joint rights;

2. hybrid class actions, which were suits involving rights in a specific property involving a strong identity of interests among the class members; and

3. spurious class actions, which necessitated only that the class shared a common question of law or fact.

The first two types of actions were relatively limited in their application. The third type of class action (the spurious class action) was not binding on absent members of the class, and was consequently somewhat unattractive. As a result, class actions, though permitted in the United States for the sake of convenience in multi-party litigation, were not frequently used prior to the amendment of the class action rules in 1966. At that time, the Federal Rules were amended to modernize the procedures applicable to class actions in the United States federal courts (with numerous of the States eventually adopting similar procedures).

Class actions are now governed by Rule 23 of the Federal Rules. The prerequisites to bringing a class action are enumerated in Rule 23(a):

One or more members of a class may sue or be sued as representative parties on behalf of all only if:

1. the class is so numerous that joinder of all members is impracticable;


(2) there are questions of law or fact common to the class;

(3) the claims or defenses of the representative parties are typical of the claims or defenses of the class, and

(4) the representative parties will fairly and adequately protect the interests of the class.

The procedure applicable to actions which meet the prerequisites above depend partially upon their characterization into one of three types of action:

(1) the prosecution of separate actions by or against individual members of the class would create a risk of

(a) inconsistent or varying adjudications with respect to individual members of the class which would establish incompatible standards of conduct for the party opposing the class, or

(b) adjudications with respect to individual members of the class which would as a practical matter be dispositive of the interests of the other members not parties to the adjudications or substantially impair or impede their ability to protect their interests; or

(2) the party opposing the class has acted or refused to act on grounds generally applicable to the class, thereby making appropriate final injunctive relief or corresponding declaratory relief with respect to the class as a whole; or

(3) the court finds that the questions of law or fact common to the members of the class predominate over any questions affecting only individual members, and that a class action is superior to other available methods for the fair and efficient adjudication of the controversy. 29

Significantly, the third classification introduced in 1966 contemplated its use for litigation involving damages. It is this significant change in emphasis which led both to increased popularity of class actions subsequent to 1966 and efforts, both domestically and internationally, to reassess its utility. 30 In ascertaining whether the

29. FED. R. CIV. P. 23(b).
30. See, Arthur Miller, supra note 28, at 665-674; John C. Coffee, Jr.,
matter fits within a type three (3) class action, the two critical issues are:

(1) whether common questions of law and fact predominate; and

(2) whether a class action is the superior procedure to use.

In making these determinations, the following matters are specifically enumerated as relevant:

(1) the interest of members of the class in individually controlling the prosecution or defense of separate actions;

(2) the extent and nature of any litigation concerning the controversy already commenced by or against members of the class;

(3) the desirability or undesirability of concentrating the litigation of the claims in the particular forum;

(4) the difficulties likely to be encountered in the management of a class action.\(^3\)

Once a class action is brought pursuant to the procedures outlined above, the Court is required to determine — at an early practicable time — whether to certify the action as a class action.\(^2\) If the action is certified as a class action, the class must be defined along with the class claims, issues or defenses.\(^3\) Further, a class counsel must be appointed pursuant to the procedures provided in the rules.\(^4\)

One important feature of class actions in the United States is the

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31. FED. R. CIV. P. 23(b)(3).
32. FED. R. CIV. P. 23(c)(1)(A).
33. FED. R. CIV. P. 23(c)(1)(B).
34. FED. R. CIV. P. 23(g) indicates that an attorney appointed to serve as class counsel must fairly and adequately represent the interests of the class. In appointing class counsel, the court must consider: the work counsel has done in identifying or investigating potential claims in the action; counsel's experience in handling class actions, other complex litigation, and claims of the type asserted in the action, counsel's knowledge of the applicable law; and the resources counsel will commit to representing the class. The Court may consider any other matter pertinent to counsel's ability to fairly and adequately represent the interests of the class and may direct potential class counsel to provide information on any subject pertinent to the appointment and to propose terms for attorney fees and non-taxable costs.
provision for class members to "opt out" and to seek their own individual redress. For class actions of the kind certified under Rule 23(b)(3), class members must be provided by the best notice practicable under the circumstances, of the following information:

1. the nature of the action,
2. the definition of the class certified,
3. the class claims, issues, or defenses,
4. that a class member may enter an appearance through counsel if the member so desire,
5. that the court will exclude from the class any member who requests exclusion, stating when and how members may elect to be excluded, and
6. the binding effect of a class judgment on class members.

The class action procedure further allows for the class action to proceed in relation to particular issues, or the action may be divided into subclasses. A judgment in such a class action, whether or not favorable to the class, shall include and specify or describe those to whom the notice was provided and who did not request exclusion, and whom the court finds to be members of the class.

In order to inhibit the misuse of class actions, procedures provide for continuing judicial supervision of the action and involvement of class members in any settlement, voluntary dismissal, or compromise. The court:

1. must approve any settlement, voluntary dismissal, or compromise of the claims, issues, or defenses of a certified class;
2. must direct notice in a reasonable manner to all class members who would be bound by a proposed settlement, voluntary dismissal, or compromise; and
3. may approve a settlement, voluntary dismissal, or compromise that would bind class members only after a hearing and on finding that the settlement, voluntary

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35. Fed. R. Civ. P. 23(c)(2)(B). This may include individual notice to all members who can be identified through reasonable effort.
dismissal, or compromise is fair, reasonable, and adequate.

The parties proposing the settlement, dismissal, or compromise must file a statement identifying any agreement made in connection with the proposal, and any class member may object to a proposed settlement, voluntary dismissal, or compromise.\textsuperscript{36}

\textbf{B. Class Actions for Securities Claims}

The use of class actions to compensate numerous plaintiffs for failures relating to securities regulation was one of the consequences of the United States class action regime. While this may have had positive effects in deterring culpable activity, assuring that numerous small claimants would not be injured without remedy, and efficiently dealing with a multitude of claims, misuse of the system also developed.

Prior to 1995, securities class actions in the United States were subject to a number of abuses attributable to elements both of the class action itself and to litigation practices in the United States procedural system, such as the existence of contingency fees and the lack of any method for requiring reimbursement of costs from unsuccessful litigants.\textsuperscript{37} Because defendant corporations bore the major share of the costs relating to the litigation (particularly the discovery costs), they were faced with the inevitability of incurring great costs relating to the litigation with no possible offsetting benefit. Further, such discovery could possibly reveal information which was not within the contemplation of the plaintiffs at the time of the original action. From the corporation's perspective, there was no possible upside—a successful defense leaving the corporation out of pocket for the costs of litigation, as well as the disturbance which such litigation caused to the internal functioning of the business.

The abuses that developed as a result of the class action system in the United States relating to securities have been frequently

\textsuperscript{36} Fed. R. Civ. P. 23(e). This has proved to be a problem elsewhere as well. \textit{See} Vince Morabito, \textit{Judicial Supervision of Individual Settlements with Class Members in Australia, Canada and the United States}, 38 TEX. INT'L L.J. 663 (2003).

discussed in academic literature, and are often referred to as "strike suits." Lawyers representing the first plaintiffs in a class action would be in a preferred position to control the litigation and to reap any benefits from a contingency fee upon recovery or settlement. As a consequence, potential plaintiffs, often with nominal share investment, would liaise with lawyers who were accustomed to managing such class actions so as to enable a quick filing of a suit when events (such as a drop in the share price of a corporation) indicated that the corporation had failed to disclose all material particulars to its shareholders or the market. Most actions were commenced within ten days of such events.

Due to the disincentives that the defendant corporations faced when opposing the class action claims, settlement of the action was often preferable to continued litigation, which would involve great expense and possible further litigation exposure. On the other side, plaintiff lawyers were faced with the decision of a quick settlement and an immediate collection of fees (set without reference to the length of the action or the total effort undertaken), or a prolonged litigation with significant time and cost for the plaintiffs as well as the defendant corporation. Not surprisingly, many of these actions were settled prior even to the completion of discovery based on a cost benefit analysis undertaken by the defendant corporation and the lawyers representing the plaintiffs. The plaintiffs received their compensation only after payment of lawyers' fees. For those plaintiffs who remained shareholders in the defendant corporation, their investment in the corporation itself suffered as a result of the

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necessary payment. Although such private action could be seen to encourage appropriate behavior by corporate management, many began to question whether, in light of the potential abuses, this was the most efficient way to assure appropriate action by corporate management.

Addressing the growing complaints about the misuse of “strike suits” relating to securities, Congress enacted the Private Securities Litigation Reform Act in 1995. This Act attempted to end the use of abusive “strike suits” by:

(1) imposing higher standards in relation to the pleadings for private securities claims to deter the filing of baseless claims and encourage plaintiffs to undertake a proper investigation before filing suit;

(2) preventing plaintiffs from abusing the discovery process in order to induce settlements;

(3) providing Court control over the determination of the lead plaintiff; and


enhancing the penalties for actions brought for an improper purpose.\textsuperscript{50}

One significant check against abusive litigation in private securities fraud actions accomplished by the Private Securities Litigation Reform Act of 1995 was the inclusion of exacting pleading requirements. The Act required plaintiffs to state with particularity both the facts constituting the alleged violation, and the facts evidencing scienter (defendant’s intention “to deceive, manipulate, or defraud.”)\textsuperscript{51} Plaintiffs must now “state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind.”\textsuperscript{52}

Because Congress left the key term “strong inference” in the pleading requirements of the Private Securities Litigation Reform Act undefined, the full implications of the pleading requirements remained somewhat uncertain and Federal Courts of Appeal had divided on its meaning.\textsuperscript{53} In \textit{Tellabs v. Makor},\textsuperscript{54} the United States Supreme Court clarified that the standard was high indeed:

In the case before us, the Court of Appeals for the Seventh Circuit held that the “strong inference” standard would be met if the complaint “allege[d] facts from which, if true, a reasonable person could infer that the defendant acted with the required intent.”\textsuperscript{55} That formulation, we conclude, does not capture the stricter demand Congress sought to convey in § 21D(b)(2). It does not suffice that a reasonable factfinder plausibly could infer from the complaint’s allegations the requisite state of mind. Rather, to determine whether a complaint’s scienter allegations can survive threshold inspection for sufficiency, a court governed by § 21D(b)(2) must engage in a comparative evaluation; it must consider, not only inferences urged by the plaintiff, as the Seventh Circuit did, but also competing inferences rationally drawn from the facts alleged. An inference of fraudulent intent may be plausible, yet less cogent than other, nonculpable explanations for the defendant’s conduct. To qualify as “strong” within the intendment of § 21D(b)(2), we hold, an inference of scienter must be more than merely plausible or reasonable — it must be cogent.

\textsuperscript{50} See \textit{id}. at § 78u-4(c). See also, \textit{Fed. R. Civ. P. 11.}


and at least as compelling as any opposing inference of nonfraudulent intent.\(^5\)

The changes made by the Private Securities Litigation Reform Act of 1995 were intended to effect a rebalancing of the litigation process in relation to securities. However, the effectiveness of the changes, including the increased pleading standards, remain uncertain.\(^6\) Consequently, concerns with the impact of class actions generally continued even after the passage of that legislation.\(^7\) In particular, class actions under the laws of various states did not replicate the limitations imposed upon class actions in the federal courts. In consequence of these limitations, state jurisdiction over class actions (primarily tort related class actions) continued to be attractive to potential litigants. Congress was concerned that plaintiffs were choosing amenable States for the determination of lawsuits of national scope and interest.

The first attempt to prevent misuse of state based class actions for securities suits occurred in 1998 with the passage of the Securities Litigation Uniform Standards Act.\(^8\) This Act attempts to pre-empt state securities law in favor of federal regulation. This is accomplished by:

1. providing exclusive federal jurisdiction for actions in which the plaintiff alleges either an untrue statement or omission in connection with the purchase or sale of securities listed on the New York Stock Exchange, the American Stock Exchange, NASDAQ, or any other national exchange with similar listing rules;\(^9\) and

2. providing exclusive federal jurisdiction for actions in which the plaintiff alleges that the defendant used a

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55. Id. at 2504-05.


manipulative or deceptive device in connection with the purchase or sale of such securities.  

In *Merrill Lynch v. Dabit*, the United States Supreme Court bolstered the effect of this legislation by determining that "holders" (those neither buying nor selling but induced to hold as a result of the culpable action) are also covered.

The concern about flight from federal class action controls was further addressed by The Class Action Fairness Act, passed in 2005. This Act did not attempt to modify the applicable Federal class action procedures, but rather made the use of State class actions more difficult by expanding federal diversity jurisdiction over interstate class actions and by broadening the powers to remove an action to the federal court and limiting the ability to have the action remanded. Additionally, the Act permits class actions to be brought in, or removed to Federal Court if:

1. at least $5 million is in controversy (excluding interest and costs); and
2. at least one plaintiff and one defendant are citizens of different states or of a state and a foreign country.

Despite the general limitation of class actions affected by the Class Action Fairness Act, securities litigation was specifically "carved out" from its operation. Nevertheless, the Class Action Fairness Act provides further evidence that control of class action litigation is continuing in the United States.

It is clear that class actions in the United States have been a very useful device for litigating issues involving a multitude of claims, including claims which would result in the award of damages. The excesses which class actions may be perceived to have instigated have

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been addressed both in relation to securities class actions and in relation to class actions generally. The *Tellabs* case confirms just how high the standards for pleading in securities fraud cases has now become, with the result that misuse of securities class actions in the United States is now, hopefully, a thing of the past. While this may prove to be so, the history of the excesses of class actions in the United States continues to plague the ready acceptance of class actions in the rest of the common law world. Nevertheless, Australia in particular has shown a willingness to embrace class actions. The Australian judicial developments which occurred in 2005-2007 (discussed below) will undoubtedly see increased litigation. That such litigation may tend toward abuse is not, fortunately, as likely in consequence of certain differences between United States and Australian law and legal culture.

**IV. Australian Class Action Procedures**

Aside from the adoption of class actions in Canada,68 Australia, and its States of Victoria69 and South Australia70 have thus far proved to be the common law jurisdictions outside North America which have been most receptive to class the United States model of actions.

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69. Supreme Court Act, 1986, Part 4A (Vic.), available at <http://www.austlii.edu.au/au/legis/vic/consol_act/sca1986183/> (visited Feb. 2, 2008) This legislation was passed after an evaluation prepared in August 1995, for the Victorian Attorney-General's Law Reform Advisory Council. See V. Morabito & J. Epstein, *Class Actions in Victoria - Time for a New Approach* (1997). After legislative inaction, the Supreme Court of Victoria added a new Order 18A to the Supreme Court (General Civil Procedure) Rules, 1996 (Vic.). This new order was challenged as beyond the judicial power of the Supreme Court, but the challenge was rejected in Schutt Flying Academy (Austl) Pty. Ltd. v. Mobil Oil Austl. Ltd. (2000) 1 V.R. 545. Before that determination could be appealed to the High Court of Australia, the Victorian Parliament enacted the abovementioned legislative framework for class actions similar to the regime under Order 18A.

70. Supreme Court Rules, 1987, Rule 34 (South Austl.), from January 1987.
The procedures for dealing with multiple parties to an action in Australia until recent times generally duplicated those found in the United Kingdom. In tracing the history of the representative action in Australia in *Carnie v. Esanda Finance Corporation Ltd.*, the High Court of Australia commenced its discussion with a summary of the iconic representative action case, *Duke of Bedford v Ellis*. Considering whether it was appropriate for a number of plaintiffs to sue on behalf of themselves and all other growers of fruit, flowers, vegetables, roots and herbs in Covent Garden, Lord Macnaghten, with whom the majority in the case concurred, identified the three criteria which must be satisfied before the representative rule could apply:

> Given a common interest and a common grievance, a representative suit was in order if the relief sought was in its nature beneficial to all whom the plaintiff proposed to represent.

In the view of the Court, there was a common interest among these growers, and it was irrelevant that the group consisted of membership that fluctuated and was thus difficult to identify and catalogue at any particular time. Further, even though the plaintiffs were claiming separate and different rights, this did not prevent them from using the representative procedure.

While the criteria mentioned by Lord Macnaghten would have provided ample opportunity for representative actions in the United Kingdom (and Australia) to develop, the English Court of Appeal, in the case of *Markt & Co. Ltd. v Knight Steamship Co. Ltd* limited the scope of the concept of "common interest" significantly. In that case, shippers sought damages for the loss of goods on a ship that was sunk during the Russo-Japanese war. A majority of the Court of Appeal determined that the shippers did not have a common interest because each contract of carriage was different from others, with potentially different defenses. As a result of this case, it was accepted

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that the representative action should exclude those cases where several damages were claimed and where individual contracts were involved.\textsuperscript{76}

Although the cases of \textit{Prudential Assurance Co Ltd v Newman Industries Ltd.}\textsuperscript{77} and \textit{Irish Shipping Ltd. v. Commercial Assurance Co. Plc}\textsuperscript{78} addressed the issue of the “same interest” required for a representative action and seemed to relax this requirement to some extent, there was not general acceptance that a representative action could be brought where the relief sought was several damages.\textsuperscript{79} This particular constraint on the usefulness of the representative action, which distinguishes that action from the United States style class action, has been subject to academic criticism\textsuperscript{80} but has continued in the United Kingdom.

Due to the perceived deficiencies of the representative action, the Law Reform Commission of Australia recommended in 1988 that changes to the group proceedings for the Australian Federal Court be allowed so as to enable actions similar to the United States class action. As a result of this recommendation, Part IVA of the Federal Court Act was introduced.\textsuperscript{81} The general objectives of Part IVA were identified in the second reading speech for the Federal Court of Australia Amendment Bill, 1991, (Austl.):

The Bill gives the Federal Court an efficient and effective procedure to deal with multiple claims. Such a procedure is needed for two purposes. The first is to provide a real remedy where, although many people are affected and the total amount at issue is significant, each person’s loss is small and not economically viable to recover in individual actions. It will thus give access to the courts to those in the community who have been effectively denied justice

\textsuperscript{76} Id. at 1040-41.
\textsuperscript{80} Rachel Mulheron, \textit{From Representative Action to Class Action: Steps rather than Leaps}, 24 CIV. JUS. Q. 424 (2005).
because of the high cost of taking action.

The second purpose of the Bill is to deal efficiently with the situation where the damages sought by each claimant are large enough to justify individual actions and a large number of persons wish to sue the respondent. The new procedure will mean that groups of persons, whether they be shareholders or investors, or people pursuing consumer claims, will be able to obtain redress and do so more cheaply and efficiently than would be the case with individual actions.\(^82\)

An action can be brought under the expanded Part VIA. Where:

1. 7 or more persons have claims against the same person;
2. the claims of all those persons are in respect of, or arise out of, the same, similar or related circumstances; and
3. the claims of all those persons give rise to a substantial common issue of law or fact;

a proceeding may be commenced by one or more of those persons as representing some or all of them.\(^83\)

The person who brings the action must have, in order to bring the representative action, a sufficient interest to commence a proceeding on his or her own behalf.\(^84\) Group members must be notified of the commencement of the proceeding and they must also be notified of their right to opt out of the proceedings.\(^85\) Generally, a person’s consent to be a group member in a representative proceeding is not required.\(^86\) Nevertheless, a group member may “opt

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83. Federal Court of Australia Act, 1976, pt. IVA, § 33C (Austl.).
84. Id. at § 33D.
85. Id. at § 33X. The method of notification is dealt with in § 33Y. In subsections (5) and (8), this section provides:
   (5) The Court may not order that notice be given personally to each group member unless it is satisfied that it is reasonably practicable, and not unduly expensive, to do so.
(8) The failure of a group member to receive or respond to a notice does not affect a step taken, an order made, or a judgment given, in a proceeding. The date by which the opt out must occur is to be fixed by the Court according to § 33J (1).
86. Federal Court of Australia Act, 1976, pt. IVA, § 33E(1),(2) (Austl.).
out” of the representative proceeding by written notice given prior to a date fixed by the Court.\textsuperscript{87} Once an action commences, the Court has significant latitude in its control of the proceedings. It may order that a representative proceeding no longer continue where it is satisfied that it is in the interests of justice to do so.\textsuperscript{88} If the determination of the issue or issues common to all group members will not finally determine the claims of all group members, the Court may give directions concerning the determination of the remaining issues.\textsuperscript{89} The Court may substitute another group member as a representative party and may make such other orders as it thinks fit if a representative party is not able to represent adequately the interest of the group members.\textsuperscript{90}

Finally, the Court has broad powers in relation to the dispute. It can do any one or more of the following things:

1. determine an issue of law;
2. determine an issue of fact;
3. make a declaration of liability;
4. grant any equitable relief;
5. make an award of damages for group members, being damages consisting of specified amounts or amounts worked out in such manner as the Court specifies;
6. award damages in an aggregate amount without specifying amounts awarded in respect of individual group members;
7. make such other order as the Court thinks just.\textsuperscript{91}

However, the Court generally must not make an award of damages in an aggregate amount. Rather it must specify amounts awarded in relation to each group member.\textsuperscript{92}

Although the class action procedure in Australia would appear to provide great scope for use in securities litigation, until recently it

\textsuperscript{87}. Federal Court Rules, 1979, § 33J (Austl.).
\textsuperscript{88}. Federal Court of Australia Act, 1976, pt. IVA, § 33N (Austl.) provides particular reasons why a Court may reach that conclusion.
\textsuperscript{89}. Id. at § 33Q(1).
\textsuperscript{90}. Id. at § 33T.
\textsuperscript{91}. Id. at § 33Z(1).
\textsuperscript{92}. Id. at § 33Z(3).
has primarily been used for tort litigation. Due to failures in the insurance industry in the late 1990s, however, the Federal government responded to calls for tort reform so as to limit claims and tighten the use of class actions for tort litigation. In consequence of these changes, Australian litigation specialists have turned their energies to trade practices and securities litigation, fields of endeavor which, unlike the United States, have largely remained unexplored in Australia.

V. Developments Improving Shareholder Claims in Australia

One interesting aspect of many colonial settlements is the tendency of the colonists to attempt to retain the customs, traditions and norms of their home culture. Because the home culture is likely to continue to evolve, colonists who cling too closely to the home culture known to them at the time of separation may find that they continue with traditions and customs despite the fact that they have been abandoned or modified in the home country. The colonial deference to the English common law found throughout much of the common law world has, since the events circa 1776, never caused significant problems in the United States. The same, unfortunately, cannot be said of Australia. The legal rights of shareholders in the broader context of company law present a case in point.

Shareholders in Australia have faced certain impediments in their efforts to seek redress after having been misled into investment. First, they were required to rescind their contract of purchase before suing the company in which they had invested under the case of Houldsworth v. City of Glasgow Bank. If able to pursue a claim, shareholders' claims were normally paid only after other creditors, irrespective of the fact that the claims related to deceitful action by the company. Finally, Australian law, like that of the United Kingdom, does not normally allow for contingency fees for lawyers.
Three recent cases from Australia, *Concept Sports, Sons of Gwalia*, and *Fostif* have each modified the long-standing impediments to shareholder actions. As a consequence, Australian shareholders are now in a much better position than their United States counterparts to pursue remedies for securities fraud.

A. Abandonment of *Houldsworth v. City of Glasgow Bank* by Australia

i. *Houldsworth as applied in Australia*

For numerous years, the English case of *Houldsworth v. City of Glasgow Bank*98 ("*Houldsworth*") prevented much securities litigation in Australia. In that case, decided in 1880, the House of Lords determined that the corporate law of both England and Scotland did not permit an action for misrepresentation or deceit by a subscribing shareholder against the company in which the shares were issued unless that shareholder first rescinded the subscription contract.

The decision in *Houldsworth* was based upon two principles. First, the court found the allowance of a claim for damages by a member against his company to be inconsistent with the implied term of the statutory contract between a member, his company, and all the other members which the constituent documents (known in Australia since the late 1990s as the Constitution, and generally known in the United States as the Articles and Bylaws) represent. This contract now finds its statutory basis in Section 140 of the Corporations Act, 2001, (Austl). That statute, among other things, indicates that the capital which the member has subscribed should be applied only in payment of the debts and liabilities of the company.99 Indicating that to allow a shareholder to seek damages for any misrepresentation or deceit when becoming a shareholder would be inconsistent with their obligations as a shareholder both to the company and to other shareholders, Earl Cairns, Lord Chancellor, stated:

But he has contracted, and his contract remains, that these assets and contributions shall be applied in payment of the debts and liabilities of the company, among which, as I have said, this [claim] could not be reckoned. The result is, he is making a claim which is inconsistent with the contract into which he has entered, and by

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which he wishes to abide; in other words, he is in substance if not in form taking the course which is described as approbating and reprobating, a course which is not allowed either in Scotch or English Law. ¹⁰⁰

Further, the decision in Houldsworth was justified by the notion that shareholders' capital was committed, in the event of liquidation, until creditors had been fully paid. Consequently, to allow a claim for damages against a company by a subscribing shareholder without rescission of the subscription contract would be tantamount to reversing the general concept of subordination of shareholders’ claims for return of capital to the claims of creditors. In the 1998 United Kingdom case of Soden v. British Commonwealth Holdings Plc.,¹⁰¹ Lord Brown-Wilkinson restated this principle in the following terms:

The relevant principle is that the rights of members as member come last, i.e. rights founded on the statutory contract are, as the price of limited liability, subordinated to the rights of creditors based on other legal causes of action. The rationale of the section is to ensure that the rights of members as such do not compete with the rights of the general body of creditors.¹⁰²

Adding further difficulty to any shareholder seeking redress against the company was the principle that once winding up of a company commenced (bankruptcy, in United States terminology), rescission of the subscription contract was no longer permissible.¹⁰³ Where rescission was not possible or where affirmation of the contract had occurred, an action in deceit provided an alternative. According to House of Lords decision in Derry v Peek,¹⁰⁴ one of the primary elements of such an action was the knowledge of the person making the representation that it was untrue. This required that (1) the defendant knew or believed the statement in question to be false;¹⁰⁵ or (2) he did not believe it to be true; or (3) he made it in

¹⁰² Id. at 324.
¹⁰⁵ This required a direct and positive untruth; an omission would not suffice unless the omission rendered that which was said to be false. See Oakes v. Turquand, [1867] 2 L.R.S. & D. App. 325; Peek v. Gurney, [1873] 6 L.R.S. & D. App. 377.
reckless ignorance of whether it was true or false. In applying these requirements to companies, there was a difference of opinion as to its application. One view indicated that a company could not be made liable for fraud, since that was a quality attributable only to a natural person, while the opposing point of view was that the fraud of an agent could make a company vicariously liable.

In order to eliminate the uncertainty surrounding the liability of the company's agents for their role in misleading investors, Section 3 of the Directors Liability Act 1890 (Eng.), the forerunner of the Australian prospectus liability provisions, was enacted. Under this legislation, every director, promoter and other person who authorised the issue of a prospectus was, subject to certain exceptions, made liable to pay damages that a subscriber suffered "by reason of any untrue statement in the prospectus." Although this had the effect of providing a statutory cause of action without the uncertainties surrounding an action for deceit, neither it nor the Australian statute modelled upon it specifically created a cause of action against the company on whose behalf the prospectus had been issued.

The uncertainty surrounding liability for false statements in a prospectus has now been resolved in the United Kingdom. The common law eventually clarified when a company would be responsible for the misrepresentations or fraudulent acts of the company's agents. More importantly, however, the rule in Houldsworth has been statutorily abrogated. Section 111A of the Companies Act, 1985, (UK) now provides:

A person is not debarred from obtaining damages or other compensation from a company by reason only of his holding or having held shares in the company or any right to apply or subscribe for shares or to be included in the company's register in respect of shares.

In contrast to the position in the United Kingdom, Houldsworth continued with vitality in Australia, since there has been no

109. Directors Liability Act, 1890, 53 & 54 Vict., c. 64 (Eng.).
110. However, legislative changes were made in 1998 which arguably had such an effect. These are discussed in the commentary concerning Cadence Asset Mgmt. Pty Ltd. v. Concept Sports Ltd, supra note 4.
111. Inserted by the Companies Act, 1989, (Eng.).
enactment in Australia similar to the United Kingdom's Section 111A. As a result, *Houldsworth*, representing as it does longstanding English precedent of continuing effect in Australia, operated to prevent shareholders from pursuing claims against corporations in which they hold shares so long as there is no statutory abrogation of the *Houldsworth* rule.

Several times in recent years the Australian judiciary has had to consider whether statutory enactments have abrogated the rule in *Houldsworth*. The most authoritative decision on the matter was the case of *Webb Distributors (Aust.) Pty. Ltd. v. Victoria,*\(^{112}\) which determined an appeal from the Victorian judgment of *Victoria v. Hodgson & Ors.*\(^{113}\)

In *Webb*, the High Court considered whether the Trade Practices Act, 1974, (Austl.), an innovative consumer-type piece of legislation intended, among other things, to prevent misleading and deceptive conduct, could be seen as abrogating the *Houldsworth* decision when the misleading and deceptive conduct was in relation to the subscription for shares. Despite the broad statutory scheme creating liability for such conduct generally, the High Court refused to accept the contention that an action by a shareholder could proceed under the Trade Practices Act in the following circumstances:

> It was the appellant's contention that the Trade Practices Act provided its "own code of remedies, unfettered."

> The Trade Practices Act is unquestionably a piece of innovative legislation. But it is not to be seen as eliminating, "by a side-wind", the detailed provisions established for more than a hundred years to govern the winding up of a company.\(^{114}\)

The decision in *Webb* indicated that specific common law principles were unlikely to be overturned unless the Australian Parliament indicated a clear intention that the common law be overturned. It was unclear what would be sufficient evidence of such Parliamentary intent.

**ii. Concept Sports: The Federal Court Questions Houldsworth**

In late 2005, the Federal Court of Australia considered the

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continuing vitality of *Houldsworth* in Australia in light of the specific provisions of the Corporations Act, 2001, (Austl.) which provided for liability for a defective prospectus in the case of *Cadence Asset Management Pty Ltd (as trustee for Cadence Capital) v Concept Sports Ltd* 15 ("Cadence").

Concept Sports Ltd sought to raise $12 million by issuing a prospectus offering 24 million ordinary shares at an issue price of $0.50 each. The prospectus contained financial information about the company, including forecast sales revenue and forecast earnings before interest and tax. The prospectus also contained statements about Concept Sports' activities, the strength of its business and the future prospects for that business. In addition, there appears to have been several implicit representations in the prospectus, to the effect that all material information had been disclosed and that all reasonable investigations had been undertaken to ensure that the information in the prospectus was accurate.

The plaintiff subscribed for shares in Concept Sports allegedly on the strength of the prospectus; however, the plaintiff asserted that:

1. the prospectus did not contain all of the information which by statute it was required to contain;
2. the forecasts for sales revenue and earnings and the statements about the company's outlook were misleading and deceptive; and
3. certain implied representations in the prospectus were false. 16

The plaintiff did not rescind the contract of subscription, but rather sold the shares to a third party at a loss. The plaintiff then sought to recover the loss (initial price ($0.50) less the average sale price ($0.115)) from Concept Sports Ltd under the liability provisions of the Corporations Act, 2001, (Austl.). 17

The operative Australian provision covering liability on a prospectus indicates that if a prospectus omits information that is required by statute, or if it contains misleading or deceptive statements that are materially adverse from the point of view of an investor, the person making the offer will have committed an offence.

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Any person who suffers loss or damage as a result may, subject to certain defences, recover that loss or damage from a number of persons, including the company making the offer.\footnote{118} Concept Sports Ltd argued that the principle espoused in \textit{Houldsworth} precluded any claim by the plaintiff. To claim any damages while avoiding the effect of the rule in \textit{Houldsworth}, it would have been necessary, according to Concept Sports Ltd, for the plaintiff to rescind the agreement to subscribe for the shares pursuant to the prospectus so as to recover the full amount of the purchase price rather than on-sell the shares to a third party and recoup the loss made on the sale.

At first instance, Justice Finkelstein of the Australian Federal Court ruled that the rule in \textit{Houldsworth} had not been abrogated by the enactment of the prospectus liability provision.\footnote{119} Relying upon the High Court decision in \textit{Webb}, Justice Finkelstein noted the following reasons for his conclusions that the reasons for denying the plaintiff’s request for relief were to be preferred over an interpretation that would allow relief. The factors that Justice Finkelstein found persuasive were that:

\begin{enumerate}
\item parliament could have, but did not explicitly overturn \textit{Houldsworth} (as had been the case in the United Kingdom);
\item parliament was aware of \textit{Houldsworth} and its consequences, and would have been able to overturn the implications of the case if it had wished to;
\item the High Court of Australia had considered a similar argument in \textit{Webb} and had rejected, in that case, the proposition that Parliament had intended to abrogate \textit{Houldsworth}; and
\item certain aspects of \textit{Houldsworth} (postponing claims of shareholders in their capacity as shareholders to claims of creditors) had been enacted by statute, and to overturn \textit{Houldsworth} would thus seem to be contradictory to that provision.\footnote{120}
\end{enumerate}
Also critical to this decision were that fact that the judgement in *State of Victoria v. Hodgson*,\(^\text{121}\) and the High Court appellate decision, *Webb*, were decisions which Justice Finkelstein felt bound by.

On appeal to the Full Federal Court, the same arguments about Parliamentary intent resulted in a determination that Parliament had, in fact, intended to abrogate *Houldsworth*. The Full Federal Court, consisting of Justices Merkel, Weinburg, and Kinney, concluded that the specific provision for liability on a prospectus did intend to supplant *Houldsworth*. The Full Federal Court found that supporting material pointed strongly away from any qualification of the statutory remedies. In coming to this conclusion, the Full Federal Court construed the language of the statute in its natural and ordinary meaning, having regard to its context. This context included other provisions of the enactment, its history and the state of the law at the time of the enactment as well as the purpose which the enactment sought to achieve.

Referring to the Explanatory Memorandum accompanying the Bill which had reformulated the prospectus provisions in 1998, the Full Federal Court indicated that it provided useful commentary, stating the purpose of the sections was “to ensure that issuers continue to provide full disclosure in the associated prospectus, issuers will be liable to investors in relation to the prospectus.”\(^\text{122}\)

In the view of the Full Federal Court, one of the rationales for the *Houldsworth* rule was to prevent shareholders, directly or indirectly, from receiving back any part of their contribution to the capital of the company, thereby defeating the interests of creditors. In contrast to the views of Justice Finkelstein at first instance, the appellate court indicated that this was now provided for in the subrogation of shareholders’ claims to those of creditors. As a result, the need for a prohibitive rule such as *Houldsworth* was no longer critical to the achievement of that objective.\(^\text{123}\)

Accordingly, the Full Federal Court found no reason for qualifying by application of the *Houldsworth* rule a claim to damages against a company for a deficient prospectus. Consequently, the


\(^{123}\) *Id.* at 446.
claim for damages by the plaintiff could proceed even though the plaintiff had not rescinded its subscription contract and was no longer capable of doing so.

**iii. Sons of Gwalia: The High Court’s Views on Houldsworth as Formerly Applied**

Although the Full Federal Court had indicated in *Concept Sports* that a company’s statutory liability to a shareholder for a misleading prospectus was not to be constrained by the common law doctrine expounded in *Houldsworth* in view of the express statutory provisions of the *Corporations Act*, the full consequences of this were considered by a number of academic authors124 and were finally considered by the High Court of Australia early in 2007. The Full Federal Court had dealt in *Concept Sports* with shareholders who had sold at a loss the shares that had been issued to them rather than seek rescission of the contract of issuance. The shareholders asserted that they had been misled by the company into investing in its shares by the company’s failure to inform the market of its true financial position.125 According to the plaintiff, the company was aware, at the time that the plaintiff acquired his shares, that the company had insufficient gold reserves to meet its gold delivery contracts. Full disclosure of this information to the market by the company as required by statute would have prevented the plaintiff from suffering losses on his shares. Both the Federal Court at first instance126 and the Full Federal Court on appeal in *Sons of Gwalia* indicated that *Houldsworth* provided no impediment to a claim by a shareholders who had acquired the shares on market and who had held those shares until the company became insolvent.127

In the final appeal of *Sons of Gwalia*, the High Court of Australia had to consider as a preliminary issue whether the Full Federal Court was correct in its view that *Houldsworth* was of limited continuing validity. Although not dealing directly with *Concept*
Australian Shareholders Rejoice

Sports, the High Court clearly determined that Houldsworth did not prohibit a claim by shareholders who had purchased their shares on the market (where rescission from the issuing company would not be possible) where a statutory liability, such as that for failure to inform the market under continuous disclosure obligations, is prescribed.

Referring to the somewhat problematic decision in Webb, Justice Hayne provided a justification for allowing the claim, distinguishing the claims of Mr. Margaretic against Sons of Gwalia Ltd. from the claims presented in Webb and Houldsworth in the following terms:

The conclusion reached in Webb Distributors concerned, and concerned only, the rights of a member who had subscribed for shares, as distinct from having acquired shares by contract from a person other than the company itself. Maintenance of capital may be relevant to a shareholder's entitlement to recover from the company amounts that the shareholder subscribed as capital, but it has no direct relevance to the recovery from the company of damages for loss occasioned by the making of a contract to acquire existing shares in the company from a third party. It has no direct relevance to that second kind of case because the shareholder does not seek the return of what was subscribed as capital when the shares were allotted. Whether, in the first kind of case, it is right to describe the claim as one which seeks the return of what was subscribed is a question that need not be answered here. Even if it were right, it would provide no reason for concluding that a shareholder like Mr Margaretic, who was not a subscriber, has no claim against the company under the consumer and investor protection provisions mentioned at the start of these reasons. Nor would it provide a reason for concluding that such a shareholder had no claim for deceit. Neither Webb Distributors nor Houldsworth established any common law “principle” that no shareholder, no matter how the shares were acquired, can have a claim of the kind now in issue against a company whose assets were to be administered as on a liquidation. The reasoning in those cases, because it was founded in important respects upon considerations of preservation of capital, can have no direct application when the plaintiff shareholder did not subscribe capital. But whether or not that is so, the asserted common law “principle” could not deny the operation of the relevant consumer protection and investor protection provisions. Finally, the conclusion reached in Webb Distributors, like the conclusion reached in Houldsworth, turned, in important respects, upon whether the shareholder could rescind the contract with the company for subscription for shares. None of these considerations is relevant to the present matters.
where there was no contract for the acquisition of shares made between the shareholder, Mr Margaretic, and the company, SOG.\textsuperscript{128}

Certain Justices of the High Court also reviewed fully the historic rationale of \textit{Houldsworth} as well as the justifications for the High Court's own previous decision \textit{Webb Distributors (Aust.) Pty. Ltd. v. Victoria}.\textsuperscript{129} Since considering the decision in \textit{Concept Sports} was unnecessary to the decision in \textit{Sons of Gwalia}, the High Court did not need to indicate whether it totally agreed with the views expressed in \textit{Concept Sports}. Nevertheless, observations by a number of the High Court Justices would lead to the conclusion that the rationale of the Full Federal Court decision in \textit{Concept Sports}, although not considered directly, would be likely to find support in the High Court if it were questioned.\textsuperscript{130}

After determining that \textit{Houldsworth} did not prohibit a shareholder from pursuing a statutory claim against his company in liquidation, the High Court also had to consider whether such claims were postponed (or deferred to the claims of other creditors) in liquidation.

\textbf{B. Ranking Shareholder Claimants as Creditors: The Primary Significance of the High Court Decision in the Sons of Gwalia Case}

One of the well-accepted tenets of corporate law is that shareholders provide their capital for shares understanding that they are exposing themselves to risk of loss, while also being likely to benefit to the greatest extent if the entity proves to be successful. The reflection of this tenet is quite straightforward if the corporation is successful: those providing loan capital normally receive contractually determined interest returns (the rate of which will normally vary depending upon the extent to which the loan is fully secured, with less secure, higher risk loans usually receiving higher returns); preferred shareholders usually have first priority to the payment of dividends from profits, often in amount and return only slightly higher than secured creditors (with their full rights to such dividends and the rights which arise in default of such declaration included within the corporate constituent documents and the terms of issue); and ordinary or common shareholders to participate (as provided in the

\textsuperscript{130} The actual decision in Concept Sports was not the subject of appeal.
corporate constituent documents) in any remaining profits to the extent that dividends are declared by the corporation.

Despite the prospect of high returns in the event of success, ordinary or common shareholders usually face higher risk than creditors in the event that the corporation is unsuccessful. In insolvency (or bankruptcy as it is known in the United States), shareholders normally are the last group to receive payment. As a result, while shareholders are the group to benefit to the greatest extent in the event of success, their capital contributions are the first to be exhausted in the event of failure. However, it is far too simplistic to say that "members come last" in liquidation,\textsuperscript{131} for the types of claims which members can assert are not limited only to the capital contributed for the issuance of shares. The landmark case concerning the separate legal personality doctrine in English law, 	extit{Saloman v. Solman & Co. Ltd.},\textsuperscript{132} itself approved the elevation of part of a member's contribution to the status of secured creditor as a result of the execution of a debenture by the company in his favour (leading inevitably to the persistent problem of thinly capitalized companies).

The Australian provision of relevance, Corporations Act Section 563A, based through a number of prior iterations upon section 38(7) of the Companies Act 1862 (U.K.), recognizes that a member can have many types of claims against the company and states simply:

Payment of a debt owed by a company to a person in the person's capacity as a member of the company, whether by way of dividends, profits or otherwise, is to be postponed until all debts owed to, or claims made by, persons otherwise than as members of the company have been satisfied.

The High Court consequently had to determine whether a statutory claim by a member against the company arising from the company's failure to meet its continuous disclosure obligations was a debt owed to that person in his capacity as a member of the company. By direct contrast, the equivalent provision in the United States Bankruptcy Code dealing with claims by shareholders, is far more certain:

For the purpose of distribution under this title, a claim arising from

\begin{footnotesize}
\textsuperscript{131} See, for example, the judgments in Sons of Gwalia of Gleason CJ, 232 A.L.R. 232 at \S 19 and Kirby J., 232 A.L.R. 232 at \S 118. Both indicate that such a general policy has not been adopted.

\end{footnotesize}
rescission of a purchase or sale of a security of the debtor or of an affiliate of the debtor, for damages arising from the purchase or sale of such a security, or for reimbursement or contribution allowed under section 502 on account of such a claim, shall be subordinated to all claims or interests that are senior to or equal the claim or interest represented by such security, except that if such security is common stock, such claim has the same priority as common stock.  

While the majority of the High Court Justices resolved the issue of whether the Australian provision should be interpreted to require postponement of such claims by reference to statutory interpretive techniques, including a review of the purpose and history of the legislation, the economic relevance of the issue was succinctly summarized by Justice Kirby (who himself agreed that the express terms of the legislation did not support this policy view):  

One can readily conceive why, as a matter of policy, strong arguments can be mounted that claims by persons such as the respondent should be postponed to claims made by the general creditors of the insolvent company. Putting it broadly, most general creditors, although not all, will be innocent of the business and entrepreneurial decisions of the company that led to its insolvency. Most will have dealt with the company as outsiders in good faith on the basis of its incorporation and, where applicable, its listing on the stock exchange and its subjection to regular and rigorous legal obligations. On the other hand, persons such as the respondent are investors. As such, they are not involved in the provision of goods and services to the company, as ordinary creditors generally are. Their interest in membership of the company is with a view to their own individual profit. Necessarily, their investment in the company involves risks, albeit risks increasingly informed by mandatory disclosures. In particular, where, as here, the company was involved in the extraction of gold, the acquisition of which notoriously and historically involves substantial risks and a significant degree of chance, the purchase of shares will commonly entail a measure — even a high measure — of speculation. Such speculation would ordinarily be expected to fall on the shareholders themselves, not shared with general creditors who would thereby end up underwriting the investors' speculative risks.  

134. See in particular the judgment of Justice Hayne, 232 A.L.R. 232, 272 et. seq.
136. Id. at ¶ 109.
The majority of the High Court (Justice Callinan being the lone dissenter) concluded on the basis of the legislation itself, that the claims made by the plaintiff were claims which any person, shareholder or not, could make if they had suffered loss or damage as a result of the company’s conduct (which was misleading and deceptive). The claim was therefore not the payment of a debt to a person in his capacity as a member. In consequence of this conclusion, the plaintiff’s claims were not postponed to those of other general creditors.

The scope of the actual decision in Sons of Gwalia was somewhat limited, relying heavily upon the specific statutory application of the term “debts owed to a person in his capacity as shareholder” in Corporations Act Section 563A to this plaintiff’s specific claims. Given the views of the High Court in reaching its decision, however, the implications of the decision are likely to be significant. Plaintiffs who have suffered loss in acquiring shares as a result of a company’s statutory breaches may make a claim in liquidation which ranks equally with other creditors irrespective of the fact that they have become shareholders through their acquisition. It appears that similar logic would apply to a shareholder who had purchased the shares on the market or from the company itself, and that there would be no necessity for the shareholder to cease being a shareholder prior to the commencement of winding up for a loss to have occurred.

137. As commented upon by Justice Hayne, “the questions that must be considered in these matters are questions of statutory construction.” 232 A.L.R. 232, 271 at ¶ 148.


139. In the view of Justice Hayne, for example, “... no distinction is to be drawn between shareholders who complain that a company’s deceit or misleading or deceptive conduct induced them to acquire shares in the company according to whether that acquisition was by subscription or transfer.” 232 A.L.R. 232, 271 at ¶ 206.

140. Although this was the case in Sons of Gwalia, more interesting is the issue of whether the retention of shares by a long standing shareholder caused by misleading and deceptive conduct by the company, if successfully proved, would also be a loss which could be claimed. It would appear that such claim, if successful, might also rank the shareholder as a creditor; however, this point was not decided in Sons of Gwalia. See the announcement by the Parliamentary Secretary, supra note 143,
significant doubt upon the continuing validity of *Webb Distributors (Aust) Pty Ltd v. Victoria*¹⁴¹ and *Houldsworth*, while lending support to the approach adopted by the House of Lords in *Soden v. British & Commonwealth Holdings Plc.*¹⁴²

As might be expected, the High Court decision in *Sons of Gwalia* caused some degree of concern about the radical departure from the common understanding about the priority of claims in insolvency. Numerous, if not all, shareholders might be able to mount some claim against their company in insolvency based upon their decision to retain shares as a result of improper information being provided to them at some point during the holding of their investment. Unlike the developments in the United States limiting class actions, shareholder and otherwise, the decision in *Sons of Gwalia* was primarily based upon statutory interpretation rather than legislative policy determinations.

To consider whether the possible blanket elevation in practical terms of shareholders to equal ranking with creditors was consistent with Parliamentary policy objectives, the Parliamentary Secretary, the Hon. Chris Pearce, referred the matter to the Corporations and Markets Advisory Committee on February 7, 2005.¹⁴³ By the terms of reference the Advisory Committee was to report to Government whether such shareholder claims should be dealt with as in the United States¹⁴⁴ and Canada¹⁴⁵ or retain the post-*Sons-of-Gwalia* position (similar to that allowed in the United Kingdom).¹⁴⁶

The discussion paper of the Corporations and Markets Advisory Committee was released in September 2007.¹⁴⁷ In it, the Corporations and Markets Advisory Committee posited three possible responses to the *Sons of Gwalia* decision:

(1) Make no legislative change and continue with the

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¹⁴⁴. The Australian perspective of the United States position is discussed in Hargovan and Harris, *supra* note 13.
¹⁴⁶. *Companies Act, 1985*, ch. 6, § 111A (Eng.) *repealed by Companies Act 2006*, ch. 46, § 1295 (Eng.).
position now adopted by the High Court;

(2) Legislatively reverse the effect of the Sons of Gwalia decision by postponing the claims of aggrieved investors so that their claims would rank behind those of unsecured creditors and equally with other member claimants; or

(3) Legislatively modify the effect of the Sons of Gwalia decision by postponing the claims of aggrieved investors so that their claims would rank behind those of unsecured creditors but would rank ahead of those of other member claimants.¹⁴⁸

For now, at least, Australian shareholders, like their United Kingdom counterparts, have much greater protection in law, as a result of Sons of Gwalia, than do their United States equivalents. However, the Corporations and Markets Advisory Committee invited submissions to consider whether aligning the Australian and United Kingdom positions was appropriate in light of material differences between the legal environments in the United Kingdom and Australia.¹⁴⁹ One major difference identified by the Committee was the availability of class actions in Australia. The second major difference identified the broader availability of funding for litigation,¹⁵⁰ now greatly improved in Australia as a result of the Fostif case, discussed below.

C. The Funding of Actions as an Alternative to Contingency Fees: the Fostif case

As in the United Kingdom and the remainder of the common law world, Australia does not provide for contingency fee litigation.¹⁵¹ Like the United Kingdom, three of the Australian States have allowed for uplift factors to compensate for actions which are somewhat speculative, these factors are allowed to exceed the standard hourly fees by a smaller percentage than is allowed in the

¹⁴⁸. Id. at 61.
¹⁴⁹. Id. at 58.
¹⁵⁰. Id.
United Kingdom. The fees are not calculated by reference to the amount of recovery or settlement, but rather on the standard rates charged by legal practitioners. Even these uplift factors are under review, with New South Wales recently eliminating its approval of uplift factors for actions involving damages. As a result of this inability of legal practitioners to be compensated on a contingency fee basis, speculative litigation was quite limited in Australia when compared to litigation practice in the United States. In the recently decided _Fostif_ case, the High Court of Australia approved of a significant alternative to contingency fees.

In _Fostif_, the High Court of Australia considered a number of representative actions brought in the New South Wales Supreme Court. These actions were brought by a number of retailers for the recovery of tobacco license fees, subsequently declared invalid, which had been paid prior to the invalidation by the retailers to wholesalers. Each plaintiff had brought an action on behalf of itself and a class of unnamed persons, in the originating petition. Applying the stricter test for representative actions found in New South Wales Supreme Court Rules, Pt. 8, rule 13(1) the High Court confirmed that the cases were not appropriate representative actions because, unlike in the _Esanda_ case, the pleading indicated that the action was brought by the plaintiff and others who decided to opt in. Subsequent to the initiating pleadings, no other person had agreed to join these actions; the plaintiff's assertion that the case was brought on behalf of numerous others with the same interests in the proceeding could not be sustained. For this reason, none of the actions were actually brought on behalf of numerous persons and consequently none were allowed to continue as representative actions. While the _Fostif_ case, brought in New South Wales, highlights the deficiencies of the representative action in contrast to class action proceedings, perhaps more interesting was the High Court's consideration the efficacy of the funding arrangements under which the actions were brought.

152. In New South Wales, conditional costs agreements may provide for a 25 percent uplift, but this no longer applies to actions for damages, Legal Profession Act, 2004, ch. 3, § 324 (N.S.W.), Victoria continues to allow a 25 percent uplift on conditional cost agreements, Legal Profession Act, 2004, ch. 3, § 3.4.14 (Vic.). Queensland allows the greatest uplift factor in Australia, Queensland at 50 percent, Queensland Barristers' Rules 121. England and Wales now allow for a 100 percent uplift, see Court and Legal Services Act 1990, ch. 41, § 58 (Eng.); see generally also Peter Melamed, _An Alternative to the Contingent Fee? An Assessment of the Incentive Effects of the English Conditional Fee Arrangement_, 27 _Cardozo L. Rev._ 2433 (2006).
Although *Fostif* was an appropriate plaintiff (a retailer seeking a refund of a tobacco tax unpaid by a wholesaler), the action was actually paid for by Firmstones. Firmstones, whose sole director was Mr Adrian Firmstone, traded as “Firmstone & Feil, Consultants.” It provided “advice and assistance in relation to indirect tax matters, including with respect to the recovery for tobacco retailers of amounts referable to state tobacco licence fees paid by tobacco retailers to tobacco wholesalers.”\(^{153}\) During 2002, Firmstones encouraged tobacco retailers to claim a refund of the tobacco license fees paid to wholesalers because those wholesalers had not remitted the tax (ruled to be invalid) to the relevant taxing authority. Firmstones wrote to tobacco retailers asking for authority to act on their behalf in recovering these amounts, and the letters indicated that there would be a “success fee” of 33 1/3 percent of any money received by the retailer from the tobacco wholesaler. If costs (legal costs related to the successful party’s litigation) were awarded to the retailer, Firmstones indicated that it would retain the sum awarded; but if costs were awarded against the retailer, Firmstones indicated that it would bear those costs.\(^{154}\) The High Court thus had to determine whether such an arrangement (litigation funding) was contrary to the prohibitions of maintenance and champerty or otherwise an abuse of the judicial process.

In resolving the issues raised by the litigation funding, the High Court reviewed the common law prohibitions on maintenance and champerty, considered the effect of New South Wales legislation which abolished those common law offences,\(^{155}\) and then expressed its view on the public policy considerations applying to such agreements. Perhaps most interesting of these aspects were the views expressed by the High Court in relation to application of such agreements to “class actions” and the evils which had arisen in the United States.

It was acknowledged by the High Court that prohibitions on maintenance and champerty had been traced as far back as 1275 in England.\(^{156}\) Despite this longstanding prohibition on maintenance (the act of assisting the plaintiff in any legal proceeding in which the person giving the assistance had no valuable interest) and champerty

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154. The facts are more fully described in the judgment.
155. See generally Maintenance, Champerty and Barratry Abolition Act, 1993 (N.S.W.).
(maintenance where the maintainor has an agreement to share in the proceeds of the suit), the policy justification was poorly articulated and subject to numerous exceptions (the exceptions to maintenance, for example, were based upon the maintainor’s charitable motives or some kind of relationship with the plaintiff). What this brief and incomplete survey of the state of the English law, as it stood by the early years of the twentieth century, may be understood as revealing is that the law of maintenance and champerty depended more upon assertion of consequences said to follow from the existence of the common law criminal offences of maintenance and champerty than it did upon any close analysis or clear exposition of the policy to which the rules were intended to give effect.

Irrespective of the policy justifications for the common law offences of maintenance and champerty, the State of New South Wales had abolished the common law offences in 1993 with the Maintenance, Champerty and Barratry Abolition Act. Nevertheless, the High Court noted that the legislation itself did not explicitly deal with whether maintenance and champerty continued to be relevant to issues of abuse of process nor with the scope that should be given to public policy or the doctrine of illegality once the conduct in question is no longer criminal or tortious. The High Court accepted the validity of the observation that there was no case where maintenance or champerty was held to be a defence to, or reason enough to stay, the action that was maintained. In relation to the argument concerning public policy, the High Court concluded that Firmstone’s seeking out those who may have had claims, Firmstone’s control of the litigation and Firmstone’s expected profit from the litigation did not, either alone or in combination, warrant condemnation as being contrary to public policy.

The High Court concluded that neither fears about the adverse effect on the process of litigation nor fears about the fairness of the

159. Fostif, supra note 157, at 78.
160. See note 155.
162. Id. at 81.
bargain struck by the litigant and the litigation funders warranted formulation of an overarching policy that would bar the prosecution of an action in such cases. To meet such fears, either by adopting a rule preventing the provision of funds in exchange for a share of the proceeds of litigation or imposing standards on the nature and degree of control or reward the funding party might obtain, would "take too broad an axe to the problems that may be seen to lie behind the fears."\textsuperscript{163}

Despite deciding that litigation funding was not necessarily abusive of public policy, the High Court's judgment in \textit{Fostif} further provides evidence that the spectre of misuse of class actions in the United States continues to concern judicial thought in Australia. While the implications of broader access to litigation funding in Australia are significant,\textsuperscript{164} the Australian High Court also acknowledged the emergence of possible abuses of process which have been addressed in the United States. It indicated that it was comfortable that such abuses could be addressed if and when they arose in Australia:

The appellants submitted that special considerations intrude in "class actions" because, so it was submitted, there is the risk that such proceedings may be used to achieve what, in the United States, are sometimes referred to as "blackmail settlements".\textsuperscript{165} However, as remarked earlier in these reasons, the rules governing representative or group proceedings vary greatly between courts and it is not useful to speak of "class actions" as identifying a single, distinct kind of proceedings. Even when regulated by similar rules of procedure, each proceeding in which one or more named plaintiffs represent the interests of others will present different issues and different kinds of difficulty.

The difficulties thought to inhere in the prosecution of an action which, if successful, would produce a large award of damages but which, to defend, would take a very long time and very large resources, is a problem that the courts confront in many different circumstances, not just when the named plaintiffs represent others

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\item[163.] \textit{Id.} at 83.
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and not just when named plaintiffs receive financial support from third-party funders. The solution to that problem (if there is one) does not lie in treating actions financially supported by third parties differently from other actions. And if there is a particular aspect of the problem that is to be observed principally in actions where a plaintiff represents others, that is a problem to be solved, in the first instance, through the procedures that are employed in that kind of action. It is not to be solved by identifying some general rule of public policy that a defendant may invoke to prevent determination of the claims that are made against that defendant. 166

VI. Securities Class Actions: Greenfield for Australian Law?

It would appear that removing the barriers to damage suits against Australian corporations would make class actions, particularly those based upon defective prospectuses and continuous disclosure failure, quite attractive. 167 Undoubtedly, the aggregation of such claims into a class action would assure that members of the class of plaintiffs who had suffered loss insufficient to warrant individual action would, through use of a class action, be able to participate in any recovery. For straightforward disclosure failures, the benefits of having one litigation would seem obvious. Concentrating upon the hypothetical case where a number of shareholders have all suffered loss as a result of misleading and deceptive statements in a prospectus, a class action would clearly advance the articulated policy objectives supporting the Australian class action:

1. It will provide access to the courts for shareholders despite that fact that each shareholder’s loss may be small and not economically viable to recover in individual actions.

2. It will allow the Courts to deal efficiently with the situation and will allow that group of shareholders,

166. Fostif, supra note 157, at 83.
167. Although more attractive than prior to 2007, class actions still remain more attractive in the United States than in Australia in many circumstances. See Clark, supra note 8, at 140. It is noteworthy that those who had suffered as a result of sanctions evasion in Iraq by the Australian Wheat Board commenced class action proceedings in the United States rather than Australia whereas shareholders have instituted action in Australia for continuous disclosure breaches against the company. Peter Veness & Kaaren Morrissey, Saddam Victims Sue AWB, THE [BRISBANE] COURIER MAIL, Sept. 2007 at 14.
Australian Shareholders Rejoice

even if the damages were large enough to justify individual actions, to obtain redress and do so more cheaply.\textsuperscript{168}

While the advantages of the class action in such circumstances is clear, a more difficult question is whether abuse of the class action in Australia will turn it from a saviour to a pest, resulting in frivolous actions instigated by entrepreneurial lawyers. Such actions, it is feared, might be brought merely for the prospect of settlement by defendant corporations to avoid litigation costs and to avoid court sanctioned “fishing expeditions” where plaintiff lawyers troll through vast amounts of material seeking information which would justify their actions. The fear of entrepreneurial advocates is widespread, and was recently expressed by Justice Callinan of the High Court of Australia:

The problems to which I have just referred are likely to be aggravated by the increasingly competitive entrepreneurial activities of lawyers undertaking the conduct of class or group actions, in which, in a practical sense, the lawyers are often as much the litigants as the plaintiffs themselves, and with the same or even a greater stake in the outcome than any member of the group. This reality is likely to be productive of a multiplicity of group actions throughout the country.\textsuperscript{169}

Previously mitigating greatly against a broad use of class action litigation in Australia was the absence of any effective contingency fee arrangement for legal practitioners and the system of awarding costs against the losing party (known in the United States as the “English rule”).\textsuperscript{170} In the United States, unsuccessful plaintiffs may incur no legal fees if they have engaged their lawyers on a contingency fee basis; however, the same would not always be true in Australia (although various plaintiff law firms do occasionally operate on a no win no fee basis). More importantly, the legal fees of the opposing party, as verified by independent assessors based upon a costing schedule, may be recovered from the party which has lost the action. For this reason, unnecessary or burdensome litigation activity will eventually be borne by the unsuccessful party to the litigation,

\textsuperscript{168} These objectives were stated in the Reading Speech, supra note 82.
\textsuperscript{169} Mobil Oil Australia Pty Ltd. v. Victoria (2002) 211 C.L.R. 1, 77.
including potentially the plaintiffs to the class action. Further adding to the discouragement of frivolous class actions is the ability of defendants to seek security for costs, thereby requiring plaintiffs to provide financial undertakings sufficient to cover the litigation costs of defendants should the defendants succeed in their defence.

The use of funding litigators, which is now permitted in Australia following the *Fostif* decision, apparently eliminates both impediments to the use of speculative class actions. Not only will the litigation funder agree to engage lawyers to pursue the action (for which the litigation funder will be liable), but also the agreement can provide that the injured party will not be liable to the litigation funder in the event that the case is unsuccessful and costs are awarded against that litigation funder. In economic terms, the litigation funder serves as a gatekeeper, assessing the potential likelihood of success, factoring in their own legal costs as well as the possible benefits or detriments of an award of costs in their favour (in the event of success) or against them (in the event of failure).

A final impediment to a more extensive use of class actions in Australia is a somewhat antagonistic attitude of many of the Australian judiciary to its use. This attitude has been reflected in interpretations which make the use of class actions much more difficult than might be expected. For example, in *King v. General Insurance Office* the Australian class action procedure was interpreted to require that the lead plaintiff in a class action and each of its members would have to plead a claim against each and every respondent. Another example of this unreceptive attitude toward class action can be seen in the judicial response to one attempt by plaintiff lawyers to overcome the difficulties of bringing a class action. An assertion that a class of plaintiffs could be limited to those members represented by one law firm (intended to ease the difficulties of funding the litigation and meeting possible costs awards) was rejected as inappropriate. As a result of such developments, it is easy to understand why it might be said that Australia, at least in relation to some aspects of class actions claims, could be “heading back in the direction of 1852” by throwing up

171. IMF Australia Ltd. and Hillcrest Litigation Services Ltd., both litigation-funding firms, are now listed on the Australian Stock Exchange. Clearly, investors place some faith in their ability to serve as commercially successful gatekeepers.
unnecessary hurdles to their pursuit. These comments, made in 2003, seem overly pessimistic in light of the *Fostif* case.

While one might argue that in Australia class actions will be unlikely to become the tool of unworthy litigants willing to bring actions without any genuine prospects of success, the recent High Court decisions make the prospect of more frequent use of class actions in Australia more likely. The High Court of Australia is aware of the possibility that class actions could be used abusively, and it is clear from the observations of Justice Kirby in the *Fostif* case that misuse of the legal system by the abusive actions will be dealt with when it becomes apparent:

... common law courts in England and in the Australian colonies provided remedies against abuse of a court's processes. Such remedies are flexible. They adapt to new times and new circumstances. Moreover, in particular cases, by particular statutory language, Parliaments can sometimes state where the balance of public interest lies [citations omitted]

Other United States legal transplants have proved to be more successful than might originally have been anticipated, but one can only hope that the Australian judiciary's removal of impediments to securities class actions discussed in this article (each justifiable in isolation) will not result in the abusive security class actions that were perceived as so problematic in the United States. Legislative intervention in Australia to reset policy in relation to shareholder claims and class action procedures may ultimately modify the judicial developments of 2007, but until then, it would seem that the United States and Australia, for the moment, are proceeding in different directions in relation to the support of shareholder litigation.

174. The comments of Justice Merkel in Bray v. Hoffman- La Roche Ltd. (2003) 130 F.C.R. 317 concerned the requirements of King v. Gen. Ins. Office, supra note 172. The issue of defining a class by its legal representative was not being commented upon.

175. *Fostif*, supra note 157, at 111 (Kirby, J.).

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