JONES DAY

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CLASS ACTION DRIVERS IN AUSTRALIA: D&O INSURANCE AND ACCESS TO DEEP POCKETS

The discontinuance of proceedings against a number of former directors in *Mercedes Holdings Pty Ltd v Waters* (No 6) [2012] FCA 1412 illustrates the importance of D&O insurance and the respondent's ability to pay in the decision-making of claimants and litigation funders. The discontinuance also highlighted the significance of proportionate liability for claims with multiple respondents as liability is linked to responsibility for loss. The significance is even greater where some respondents are insolvent or have limited financial resources.

INTRODUCTION

The MFS Premium Income Fund class action ("MFS class action") recently saw the applicant, a unit holder in the fund, discontinue proceedings against a number of former directors of the responsible entity for the fund. The discontinuance of a class action must be approved by the court,[1] with the result that the judgment—*Mercedes Holdings Pty Ltd v Waters (No 6)* [2012] FCA 1412—provides an insight into the drivers for claims against directors and auditors: funds to meet a judgment or settlement.

CLAIMS AGAINST DIRECTORS

Central to the applicant's reasons for seeking a discontinuance was that the directors' and officers' liability policy which responded to the claims was capped at a confidential figure but that the policy was, or would soon be, exhausted.

The policy had been used to meet defense costs of the settling respondents in defending the present proceedings. The policy also responded to other claims, including a civil penalty proceeding brought by the Australian Securities and Investments Commission in the Supreme Court of Queensland against three of the settling respondents. Consequently, upon the basis of estimates of anticipated future legal costs, no insurance moneys were expected to be available to meet a judgment in the current proceedings. Further, evidence established that each of the settling directors had insufficient assets to meet a judgment.

Presumably related to the lack of funds to pay a judgment, the court was informed that the litigation funder who was funding the proceeding no longer wished to fund the litigation against the settling directors.

The MFS class action demonstrates that a central factor in parties being joined to class action litigation is their ability to contribute funds to a settlement or judgment. Litigation funders have no interest in pursuing claims against parties that lack financial resources. A pyrrhic victory does not assist the funder's profit-making objectives. This approach also means that the funder has an incentive to target entities that have "deep pockets"—in this case the auditor, KPMG, which is discussed below.

The discontinuance was also explained as being consistent with the obligations of the parties under sections 37M and 37N of the Federal Court of Australia Act to further the overarching purpose through narrowing the issues in dispute and seeking to resolve the proceeding at a cost that is proportionate to the importance of the proceeding. Interestingly, the applicant did not seek to discontinue proceedings against another director, Mr Price, even though Jacobson J found that the essential reasons for discontinuing against the other directors applied to Mr Price. Despite the obligations imposed by the overarching purpose, Jacobson J stated that he did not consider it open to him to require an explanation for the decision to continue the proceeding against Mr Price.

PROPORTIONATE LIABILITY AND AUDITORS

After the major cases of the 1980s against auditors, such as *AWA* and A*delaide Steamship*, various reforms were added to the law so as to ensure audit firm continuity but still allow for litigation to deter contraventions and compensate investors: caps on liability and proportionate liability where there are multiple wrongdoers. The incentive to sue "deep pockets" means that those reforms are now likely to be implicated in class actions. In particular, the *MFS* class action raised the issue of proportionate liability.

In the *MFS* class action, KPMG indicated that they intended to rely in their defense upon a limitation of liability afforded under the proportionate liability legislation for apportionable claims which is now in force throughout Australia. Indeed, after Jacobson J reserved judgment on the motion for approval of the discontinuance, the auditors filed a defense which claims that each of the settling respondents, with the exception of the 15th respondent, Mr Zelinski, was a concurrent wrongdoer within the meaning of the proportionate liability regimes contained in the New South Wales, Queensland, and Victorian legislation.

However, KPMG were concerned that if the applicable regime for the determination of proportionate liability is the *Wrongs Act 1958* (Vic), the discontinuance of the proceedings against the settling respondents may prejudice the ability of the auditors to obtain the full benefit of their limitation of liability under that Act. Jacobson J took the view that based on undertakings by the former directors and his view of the operation of the Victorian legislation, the auditor's concerns should not prevent the court approving the discontinuance.

The *MFS* class action demonstrates that the proportionate liability legislation is likely to figure prominently in cases with multiple respondents.[2] This is because the legislation, generally speaking, has the effect that liability in relation to the applicant's (and group members') claim is apportioned amongst concurrent wrongdoers, so the liability of any individual respondent is limited to an amount reflecting the proportion of the loss claimed that the court considers just, having regard to the extent of the respondent's responsibility for the loss. Note, however, that the apportionment applies only to apportionable claims, which usually include claims in negligence or misleading conduct causing economic loss or property damage, and is therefore not applicable to all claims.

Where an entity, such as an auditor, is the only entity with financial resources, proportionate liability can mean that it is not liable for all the loss suffered by the applicant (and the group members) but only the loss that is attributable to its wrongdoing.

LAWYER CONTACTS

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ENDNOTES

1 Section 33V of the *Federal Court of Australia Act 1976* (Cth).

2 *See also Wingecarribee Shire Council v Lehman Brothers Australia Ltd (in liq)* [2012] FCA 1028 at [1085] and B*athurst Regional Council v Local Government Financial Services Pty Ltd (No 5)* [2012] FCA 1200 at [3483].