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NATIONAL AUSTRALIA BANK CLASS ACTION SETTLEMENT APPROVED

The National Australia Bank ("NAB") class action settlement of A$115 million, including interest and legal costs of about A$11.8 million, has been approved by the Supreme Court of Victoria.[1] The NAB settlement makes it the third largest shareholder class action settlement in Australian history, behind the Centro settlement of A$200 million (although PriceWaterhouseCoopers contributed an estimated A$67 million) and the Aristocrat Leisure settlement of A$144.5 million and just ahead of the GIO settlement of A$112 million and the Multiplex settlement of A$110 million. Shareholder class actions remain profitable investments for litigation funders and plaintiff's lawyers as well as significant business risks for corporate Australia.

The NAB class action settlement judgment reinforces the existence of a number of characteristics about shareholder class actions but also provides some new insights.

CRITERIA FOR APPROVING SETTLEMENT

Section 33V(1) of the *Supreme Court Act 1986* (Vic) makes any settlement of a group proceeding dependent upon approval by the court. Similar requirements exist in the Federal and NSW class action regimes.[2]

The criteria for approving settlements in the Federal Court has been discussed on a number of occasions[3] and are now consolidated in Federal Court of Australia, Practice Note CM17, *Representative Proceedings Commenced under Part IVA of the Federal Court of Australia Act 1976*, 1 August 2011.

The Supreme Court of Victoria has had less opportunity to consider the relevant criteria but has nonetheless specified criteria in Supreme Court of Victoria, Practice Note No 9 of 2010, *Conduct of Group Proceedings*, 29 November 2010. The practice note is not cited in the NAB judgment. Instead reference is made to a number of first instance Federal Court judgments that encapsulate the following overriding requirements, namely:[4]

- Settlement must be undertaken in the interests of group members as a whole, and not just in the interests of the plaintiff and the defendant; and

- The practical judicial approach is to identify any features of a settlement that are obviously unreasonable or unfair.

The Supreme Court emphasised that an important consideration for a court will be the candid opinion which the practitioners for the parties, and particularly for the party representing the group members, give in recommending the settlement.[5] The Court observed that the practitioners had the best appreciation of the issues and were expected to give a candid opinion as to why the settlement should be approved. The Court distinguished between the practice of providing the Court with submissions on the settlement and an opinion, akin to that of an expert witness, which candidly evaluated the strengths and weaknesses of a party's case, as well as any benefits which flowed to the lawyers from the settlement. The Court expressed a preference for the latter and so it may be that class action practice changes as a result.[6]

CAUSATION AND DAMAGES STILL IN DISPUTE

The Supreme Court, in considering the fairness and reasonableness of the compromise reached in the settlement, observed that a principal area of dispute between the parties was causation.[7] The traditional position has been that each group member must prove reliance in order to establish a causal connection between the bank's alleged contraventions and the loss alleged to have been suffered. This is compared to market-based causation, whereby group members suffer loss by reason of the market price of the NAB shares being artificially high as a result of the alleged misrepresentations and non-disclosures.[8]

The Court observed that "neither case is so certain as to justify disregarding the possibility of success or failure" and therefore "a settlement of the proceeding avoids the possibility of adverse findings on liability and causation and that settlement provides a significant advantage to group members which justifies a substantial discount against the total amount claimed".[9] The requirements for proving causation remain uncertain, but that uncertainty is a justification for compromise.[10]

In relation to damages, the Court observed that a number of different methodologies had been put forward, including the use of an event study[11] to determine the measure of inflation in the security price caused by the bank's alleged misconduct. However, the expert opinions provided a range of outcomes that had not been tested.[12] In a previous judgment, the claims against NAB were estimated to be worth A$450 million.[13] A comparison of the settlement excluding legal costs with the estimate gives a recovery of 23 percent of losses. Nonetheless, the Court accepted that "the amount agreed to between the parties fairly and reasonably reflects the quantum of the claim discounted by appropriate risks of litigation and benefits of resolution of the proceeding without the need for a lengthy trial".[14]

The value of the claim and the size of the settlement raise questions as to whether the uncertainty surrounding causation and damages is responsible for steep discounts on settlement, or whether early estimates (often aimed at recruiting group members) lack rigor. Either state of affairs has important ramifications. Lawyers for the plaintiffs have stated, "It's difficult to assess what the damages are in a shareholder action. Mainly because it's a new jurisdiction in Australia and we don't have set precedents about what the right measurement of losses is".[15] However, settlements that are one quarter of the estimated losses suggest that Australian shareholder class actions are starting to look like what the Americans call "strike suits"—claims that impose high costs which create an incentive to settle despite the probability of a successful recovery for the group being low.[16]

CONFIDENTIALITY

The use of confidentiality to prevent evidence provided to a court being accessed by the public raises the conflict between the principal of open justice and the need, in certain circumstances, to protect confidential material so as to allow a court to do justice.[17]

The Supreme Court raised this conflict in relation to class action settlements where confidentiality is sought in relation to a range of matters including opinions from the legal representatives and the formula for calculating loss and allocating the settlement. Class actions squarely raise the public interest, especially in relation to shareholder claims that are seeking to enforce provisions aimed at achieving an informed market and protecting investors.[18] Class actions also need to pay special attention to group members, who may be permitted to access confidential information but are unable to do so.[19] This may be the result of some combination of cost and/or lack of understanding.

The Supreme Court's discussion of confidentiality may mean closer scrutiny of requests for court orders restricting access to evidence. In the Federal Court context, the High Court of Australia has observed that it is insufficient that the making of an order under s 50 of the *Federal Court of Australia Act 1976* (Cth) appears to be "convenient, reasonable or sensible, or to serve some notion of the public interest". Rather, the order must be "necessary in order to prevent prejudice to the administration of justice".[20]

Parties and their legal representatives need to give close attention to identifying truly confidential information and provide supporting evidence (usually in the form of an affidavit) for the court to make the requisite orders.

PRACTICAL GUIDANCE

The NAB shareholder class action settlement judgment provides the following guidance:

- Class action settlements must be approved by a court and therefore are open to public scrutiny unlike settlements in commercial litigation.

- Settlement approval requires evidence that demonstrates that the settlement is fair and reasonable. While the plaintiff has chiefly borne this responsibility in the past, it may be that defendant's counsel will be expected to also provide an opinion on the settlement. Any such opinion should be dealt with so as to preserve legal professional privilege where possible.

- Where court orders are sought to protect confidentiality as part of a settlement, it is crucial that sufficient supporting evidence (usually in the form of an affidavit) is provided so that the court can make the requisite orders.

- The substantive law on causation and calculation of damages in shareholder class actions remains unsettled. The NAB settlement does not change this. However, it does illustrate that uncertainty can create an opportunity for settlements to be negotiated because both sides need to factor in that they may be unsuccessful. However, the strength of the plaintiffs' theory on causation impacts the value of a shareholder class action. If the cogency of the plaintiffs' theory on causation is diminishing, then greater discounts to claims can be expected.

LAWYER CONTACTS

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ENDNOTES

1 *Pathway Investments Pty Ltd v National Australia Bank Limited (No. 3)* [2012] VSC 625.

2 *Federal Court of Australia Act 1976* (Cth) s 33V and *Civil Procedure Act 2005* (NSW) s 173.

3 *See Taylor v Telstra Corporation Ltd* [2007] FCA 2008 and *Pharm-a-Care Laboratories Pty Ltd v Commonwealth of Australia (No 6)* [2011] FCA 277.

4 *Harrison v Sandhurst Trustees Ltd* [2011] FCA 541 at [13] and *Darwalla Milling Co Pty Ltd v F Hoffman-La Roche (No 2)* (2006) 236 ALR 322 at [39].

5 *Pathway Investments Pty Ltd v National Australia Bank Limited (No. 3)* [2012] VSC 625 at [3].

6 *Pathway Investments Pty Ltd v National Australia Bank Limited (No. 3)* [2012] VSC 625 at [3] and [6].

7 *Pathway Investments Pty Ltd v National Australia Bank Limited (No. 3)* [2012] VSC 625 at [11].

8 See John Emmerig, "Causation and Damages in Shareholder Class Actions", *UNSW CLE - Class Actions*, Sydney, 25 October 2012.

9 *Pathway Investments Pty Ltd v National Australia Bank Limited (No. 3)* [2012] VSC 625 at [12].

10 Michael Legg, "Causation and Damages in Shareholder Class Actions: a Settlement Perspective", *UNSW CLE - Class Actions*, Sydney, 25 October 2012.

11 Event studies are a form of regression analysis which seeks to measure materiality and the magnitude of the impact of a misrepresentation on the share price by removing other unrelated events such as general market or industry-wide events. *See Taylor v Telstra Corporation* [2007] FCA 2008 at [21]–[22].

12 *Pathway Investments Pty Ltd v National Australia Bank Limited (No. 3)* [2012] VSC 625 at [12].

13 *Pathway Investments Pty Ltd v National Australia Bank Limited (No. 3)* [2012] VSC 97 at [47].

14 *Pathway Investments Pty Ltd v National Australia Bank Limited (No. 3)* [2012] VSC 625 at [12].

15 Matthew Drummond and George Liondis, "NAB settles class action for $115m", *The Australian Financial Review*, 9 November 2012.

16 *See Blue Chip Stamps v Manor Drug Stores* 421 US 723, 740-743 (1975) and Janet Cooper Alexander, "Do the Merits Matter? A Study of Settlements in Securities Class Actions" (1991) 43 *Stanford Law Review* 497, 548–550.

17 *Hogan v Hinch* (2011) 243 CLR 506 at [20]–[21] and *Hogan v Australian Crime Commission* (2010) 240 CLR 651 at [42].

18 Michael Legg, "Public and Private Enforcement" in Michael Legg (ed), *Regulation, Litigation and Enforcement* (2011) at 161-162.

19 *Pathway Investments Pty Ltd v National Australia Bank Limited (No. 3)* [2012] VSC 625 at [5].

20 *Hogan v Australian Crime Commission* (2010) 240 CLR 651 at [31]–[32].