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COMMENTARY

Litigation for Profit in Australia–Court Imposes Limits Where Serious Conflicts of Interest Exist

- New entrants are being drawn to the Australian securities litigation market by returns received by litigation funders and lawyers.
- One new entrant is Melbourne City Investments Pty Ltd ("MCI"), which was found to have probably been created to launch class actions to enable its sole director and shareholder, Mr Mark Elliott, to earn legal fees from acting as the solicitor for MCI.
- Due to concerns about a real risk of a conflict of interest, the Court ordered that Mr Elliott be restrained from acting for MCI in two shareholder class actions while MCI is the lead plaintiff, and that both proceedings not be permitted to continue as class actions while MCI and Mr Elliott act in tandem as plaintiff and solicitor.
- In a third shareholder class action, MCI was found to lack standing as it had no claim for compensation and could not continue the class action.

Litigation for Profit–New Entrants in the Securities Litigation Market

In the last six to eight months, Australia has witnessed a spike in shareholder class action activity that appears to be driven, at least in part, by new lawyers and litigation funders entering the market.[1]

Between October and December 2013, MCI as representative party commenced shareholder class actions against Leighton Holdings Limited, Treasury Wine Estates Limited, and WorleyParsons Limited. All three claims were in relation to allegations of defective disclosure to the securities market.

The solicitor acting for MCI was in all cases Mr Mark Elliott. Mr Elliott was also the sole director and shareholder of MCI.

MCI was incorporated on 1 November 2012. On the day of its incorporation, MCI purchased 39 shares in Leighton for $684.06, 140 shares in Treasury for $693.00, and 28 fully paid shares in WorleyParsons for $694.96.

In addition, on 1 November 2012, MCI purchased parcels of shares in another 17 publicly listed companies, each parcel costing a little under $700. In February 2014, MCI purchased further small parcels of shares in another 145 publicly listed companies.

In each class action, the Supreme Court of Victoria has prevented the continuation of the class actions as currently conceived.

Class Actions Against Treasury Wine Estates and Leighton Holdings–Real Risk of Conflict of Interest

Treasury Wine and Leighton contended that the proceedings against them were brought by MCI for the collateral purpose of generating legal fees for Mr Elliott, and they sought a range of relief including that each proceedings was an abuse of process and should be stayed. Alternatively, they sought orders in the exercise of the inherent jurisdiction of the Court to restrain Mr Elliott from acting for MCI in the proceedings whilst MCI is the lead plaintiff.

Justice Ferguson found "it is probable that the reason for MCI's existence is to launch proceedings, such as the present proceedings, to enable its sole director and shareholder to earn legal fees from acting as the solicitor for MCI".[2] The small shareholdings held by MCI meant that the compensation that MCI stood to gain would be less than $700 in each class action. Justice Ferguson inferred that it was therefore unlikely that proceedings were commenced for the purpose of recovering compensation. The inferences or findings may have been rebutted by MCI's director, Mr Elliott, if he had given evidence. No such evidence was given.[3]

The Court has inherent jurisdiction to stay proceedings where they are an abuse of process, which includes where the proceedings are predominantly brought for an improper purpose. However, the power of a stay is to be used only in exceptional circumstances. Justice Ferguson found that as MCI had the immediate and legitimate purpose of obtaining orders for compensation—and to stay the proceedings would broaden the abuse of process concept beyond its recognised boundaries—no abuse of process existed.

Rather, the concern was with the conduct of the solicitor. The Court also has inherent jurisdiction to make orders to ensure the due administration of justice and to protect the integrity of the judicial process, including restraining a legal practitioner from acting in proceedings. The principles for restraining a legal practitioner are:[4]

- The test to be applied is whether a fair-minded, reasonably informed member of the public would conclude that the proper administration of justice requires that a lawyer should be prevented from acting, in the interests of the protection of the integrity of the judicial process and the due administration of justice, including the appearance of justice.
- The jurisdiction is exceptional and is to be exercised with caution.
- Due weight should be given to the public interest in a litigant not being deprived of the lawyer of his or her choice without due cause.
- The timing of the application may be relevant, in that the cost, inconvenience and impracticality of requiring lawyers to cease to act may provide a reason for refusing to grant relief.

A number of arguments were put forward as to why Mr Elliott should not continue as the solicitor on the record. These include:

- Mr Elliott may be required to give evidence in his role as sole director of MCI.
- Evidence may be "adjusted" because of Mr Elliott having a personal pecuniary interest in the outcome of the proceedings.
- A conflict exists between Mr Elliott's pecuniary interest and his duty to the court.
- A conflict exists between Mr Elliott's duty to MCI as its director and the interests of the group members.

The last of these arguments, essentially the possibility of a duty–duty conflict, was relied on by Justice Ferguson, who stated:[5]

> the [hypothetical fair-minded independent observer] would consider that Mr Elliott is compromised in his role as a solicitor such that there would be a real risk that he could not give detached, independent and impartial advice taking into account not only the interests of MCI (and its potential exposure to an adverse costs order), but also the interests of group members.

A number of arguments were also made for the discontinuance of the class action, but the Court found that that there was nothing irregular about the proceedings. The Court did rely on the power in the class actions legislation to make orders it thinks "appropriate or necessary to ensure that justice is done in the proceeding".

The Court ordered that Mr Elliott be restrained from acting for MCI whilst it is the lead plaintiff and that the proceedings not be permitted to continue as group proceedings whilst MCI and Mr Elliott act in tandem as plaintiff and solicitor.

Class Action Against Worley Parsons–No Standing

MCI commenced proceeding on its own behalf and on behalf of all persons who acquired ordinary shares in WorleyParsons on or after 14 August 2013 and who were, at the commencement of trading on 20 November 2013, holders of any of those shares. MCI was not a member of the group it sought to represent. It purchased its shares prior to the alleged misleading conduct.

MCI alleged that WorleyParsons published forecasts of increased earnings on four occasions between August and midOctober 2013 which it had no reasonable grounds for making and which were misleading or deceptive in breach of s 1041H of the *Corporations Act 2001* (Cth). MCI alleges that WorleyParsons corrected its earnings forecast on 20 November 2013. MCI claims that the fall in the price of WorleyParsons' securities after 20 November 2013 was a result of WorleyParsons' conduct.

MCI alleged that group members suffered loss and were entitled to compensation pursuant to ss 1041I and 1325 of the *Corporations Act*. However, MCI did not itself make any claim for compensation. MCI sought declarations that WorleyParsons contravened s 1041H and that the group members were entitled to compensation and interest.

WorleyParsons successfully challenged MCI's ability to bring the class action on the basis that it lacked standing. MCI sought to argue that it was enforcing a public right. Justice Ferguson observed that "[w]hilst MCI sought to elevate its position as the lead plaintiff well above the ordinary member of the public, there is no basis for doing so".[6] MCI argued that a different approach to standing is taken in relation to lead plaintiffs and class actions. But the lack of a claim for damages or the pleading of anything else to show that MCI had a real interest in seeking declaratory relief meant the requirements for standing were not satisfied.

Lawyer Contacts

For further information, please contact your principal Firm representative or one of the lawyers listed below. General email messages may be sent using our "Contact Us" form, which can be found at www.jonesday.com.

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Endnotes

1 *See* Jones Day *Commentary*, "Securities Class Actions Escalate in Australia" (May 2014) http://www.jonesday.com/securities-class-actions-escalate-in-australia-05-14-2014.

2 *Melbourne City Investments Pty Ltd v Treasury Wine Estates Limited (No 3)* [2014] VSC 340 at [9].

3 *See Jones v Dunkel* (1959) 101 CLR 298 for the common law principle that where a party fails to tender evidence or call a witness, it may be inferred that nothing in that absent testimony or evidence would have assisted the party's case.

4 *Melbourne City Investments Pty Ltd v Treasury Wine Estates Limited (No 3)* [2014] VSC 340 at [39] citing *Kallinicos v Hunt* (2005) 64 NSWLR 561.

5 *Melbourne City Investments Pty Ltd v Treasury Wine Estates Limited (No 3)* [2014] VSC 340 at [50].

6 *Melbourne City Investments Pty Ltd v WorleyParsons Limited* [2014] VSC 303 at [22].