
What price investor protection? Class actions vs Corporate rescue

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The financial turmoil and share market losses generated by the global financial crisis have provided ideal conditions for increased numbers of investor class actions. The numbers of firms involved in litigation funding and law firms involved in class actions are also increasing. Australian securities law seems to be at the beginning of a wave of investor class actions based on allegations of inadequate corporate disclosure. The fallout from the global financial crisis (GFC) has also focused attention on the efficiency of Australia's corporate rescue laws as companies struggle under onerous debt levels and attempt to rebuild balance sheets and restructure operations in much tighter credit conditions than in previous years. This article considers the tension between laws that seek to compensate investors through the use of class actions and laws that aim to promote corporate rescue attempts. It suggests that reform may be needed to ensure that these two important policy goals work more harmoniously together.

PT I – INTRODUCTION

The past 30 years have seen tremendous change in the legal and business approaches to addressing the problem of corporate financial distress. The opening up of Australia's markets to increasing global competition has put pressure on Australian businesses to strive for ever-greater efficiencies. One important driver in this environment has been the increasing globalisation of financial markets. Australian businesses, particularly large-listed companies, are now competing for capital in a global marketplace.

Australia's attraction as a global investment destination is determined by a number of factors, including the efficiency of our product and capital markets. One element contributing to the value and competitiveness of our product and service providers is the efficient use of capital in the overall economy. Effective corporate rescue and restructuring laws play an important role in promoting an efficient allocation of resources by allowing viable businesses to be saved rather than simply liquidated.¹ It is therefore important that the goal of corporate rescue, where appropriately applied, is not unwittingly compromised by the side-wind of unrelated policy goals. While insolvency law should strive to integrate itself within the broader business regulatory framework as harmoniously as possible, the application of inefficient rules ex post may lead to increased costs ex ante.²

The past 30 years have also seen the rise of consumerism and consumer protection laws, which in more recent times, has permeated corporate law.³ In corporate law, the drive for consumer protection has resulted in a range of "investor protection" measures. The centrepiece for investor protection

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The authors would like to thank the anonymous referee and the Journal's editor, Dr Colin Anderson, for their helpful comments and suggestions. All errors and omissions remain the sole responsibility of the authors.

¹ As will be discussed below, there is considerable debate about the policy value of pursuing a goal of corporate rescue as a first choice for *particular* firms in financial difficulties. However, there is no doubt that an effective corporate rescue regime promotes the efficient allocation of resources as part of a regulatory toolbox for dealing with corporate financial strain across the economy.

² See further Jackson T, *The Logic and Limits of Bankruptcy* (Harvard University Press, 1986); Routledge J, "Part 5.3A of the Corporations Law (Voluntary Administration): Creditors' Bargain or Creditors' Dilemma?" (1998) 6 *Insolv LJ* 127.

³ For a detailed discussion see Legg M, "Shareholder Class Actions in Australia – the Perfect Storm?" (2008) 31 *UNSW Law Journal* 669 at 671-674.

regulation has been the primacy given to corporate disclosure practices.⁴ The culture of disclosure that has been forced upon Australian corporations, particularly public corporations, is aimed at promoting the efficiency of the capital markets' pricing mechanism. The underlying theory involves an assumption that markets will price financial products (including shares and debt securities offered by public companies) to reflect the value of the enterprise based on publicly available information.⁵ Investor protection laws have therefore focused on improving the timeliness and accuracy of information disclosed by public corporations. The policy goal is that sufficient (accurate) information will be provided to investors to allow them to make appropriate investment decisions. Disclosure laws are given "teeth" by a range of administrative and judicial sanctions that may be brought to bear on market participants (including both advisors and product issuers). Sanctions may be sought through a mix of public and private enforcement mechanisms. Maintaining timely, accurate and comprehensive information about public companies and their securities contributes to public confidence in the integrity of the capital markets, which in turn should help lower the relative cost of capital for Australian companies.⁶

Given Australia's increasing investment in corporate equity and debt securities,⁷ as demonstrated by the vast amounts of wealth locked up in superannuation,⁸ the transparency of our capital markets is a worthy and important policy goal.

The tension between the goals of effective investor protection and corporate rescue procedures has been clearly demonstrated by the global financial crisis that began in 2007.⁹ The impact of share price declines and debt that could not be refinanced saw corporations needing to negotiate with secured creditors for their continued survival while also facing class actions from disgruntled shareholders.¹⁰

This article discusses the tensions that exist between the policy goals of efficient and effective corporate rescue laws and investor protection laws. In particular, the authors will examine the potentially damaging implications of investor class actions on corporate rescue attempts. The purpose of this analysis is to evaluate whether, and how, the tension between these two competing policy goals may be resolved. The second part of the article provides an overview of the scope for investor class actions in Australia. The third part of the article gives a brief account of the scope of Australia's corporate rescue law: voluntary administration. The fourth part of the article critically evaluates the

⁴ See *Corporations Act 2001* (Cth), ss 728, 729 (right to seek compensation for defective disclosure in prospectus documents), 1041H, 1041I (right to seek compensation for misleading or deceptive conduct in relation to financial services), 1325 (right to seek compensation in respect of disclosure contraventions).

⁵ For a discussion of the efficient market hypothesis (EMH) see Fama E, "Efficient Capital Markets: A Review of Theory and Empirical Work" (1970) 25 *Journal of Finance* 383, and for its application to Australian capital markets: Groenewold N and Kang K C, "The Semi-Strong Efficiency of the Australian Stock Market" (1993) 69 *The Economic Record* 405. For an Australian critique of the EMH see Sappideen R, "Securities Market Efficiency Reconsidered" (1988) 9 *University of Tasmania Law Review* 132. For a discussion of the empirical finance literature on the EMH: see Megginson M, *Corporate Finance Theory* (Addison-Wesley, 1997) Ch 3.

⁶ See further La Porta R, Lopez-de Silanes F, Shleifer A and Vishny R W, "Investor Protection and Corporate Valuation" (2002) 57 *Journal of Finance* 1147.

⁷ The 2008 Share Ownership Survey produced by the ASX establishes that 41% of Australians own shares directly or indirectly. Copies of the survey are available from the ASX website: see <http://www.asx.com.au> viewed 31 October 2009.

⁸ APRA recently announced that assets held in Australian superannuation funds reached \$1.08 Trillion: see Quarterly Superannuation Performance (June 2009) released 24 September 2009, available at <http://www.apra.gov.au> viewed 31 October 2009.

⁹ For an overview of the regulatory issues associated with the global financial crisis see Legg M and Harris J, "How the American Dream became a Global Nightmare: An Analysis of the Causes of the Global Financial Crisis" (2009) 32 UNSWLJ 350.

¹⁰ See Ferguson A, "Class Actions on the Increase", *The Australian* (4 January 2008) p 15; Lampe A, "The Shifting Battleground" (2008) 24(2) *Company Director* 24 at 26, Duncley M and Drummond M, "Bank Leadership Key to Centro Survival", *The Australian Financial Review* (30 September 2008) p 59 and Boxsell A, "Mum and Dad Take to Class Action", *The Australian Financial Review*, (11-12 July 2009) p 37 referring to corporations such as Centro Properties Group, Centro Retail Group, Allco Finance Group, ABC Learning Group, Babcock & Brown, Octavia (formerly named MFS), GPT and Oz Minerals.

tension between these two regulatory policies. The last part concludes the article by considering the need for law reform to address the problems identified in Pt IV.

PT II – THE ROLE AND VALUE OF INVESTOR CLASS ACTIONS

The class action procedure

The intricacies of the class action procedure in Australia have been the subject of much academic and practitioner analysis, which renders a detailed discussion of the procedures unnecessary.¹¹ However, in order to appreciate the potential impact of investor class actions on corporate rescue procedures it is appropriate to discuss the basic elements involved in running a class action in Australia.

In Australia, investor or “securities”¹² class actions may take two broad forms. First, the Federal Court of Australia and Victorian Supreme Court both maintain a specific class action procedure.¹³ Aside from these two procedures, all State supreme courts provide for a form of group or representative proceedings.¹⁴ However, as most class actions are brought under the Federal Court provisions (which are mirrored by the Victorian Supreme Court provisions), the focus will be on those provisions.

The Federal Court representative procedure requires that a valid class action have seven or more persons with claims against the same person¹⁵ and those claims are “in respect of, or arise out of, the same, similar or related circumstances”.¹⁶ Each of the claims must “give rise to a substantial common issue of law or fact”.¹⁷ The representative party must be a person who has a sufficient interest in the matter to support their own action against the respondent.¹⁸

The applicant’s pleadings in a class action must describe or otherwise identify the group members and specify the common questions of law or fact, in addition to complying with the usual pleading requirements.¹⁹

Even where the requirements for a representative proceeding are satisfied, the court has a discretion, upon its own motion or on application by the respondent, to terminate the class action where the court is satisfied that it is in the interests of justice to do so. This is because, inter alia, the

¹¹ For a detailed analysis of Australian class action procedures see: Grave D and Adams K, *Class Actions in Australia* (Lawbook Co, 2005); Cashman P, *Class Action Law and Practice* (Federation Press, 2007); Spender P, “Securities Class Actions: A View from the Land of the Great White Shareholder” (2002) 31 *Common Law World Review* 123; Clark S and Harris C, “Class Actions in Australia: (Still) a Work in Progress” (2008) 31 *Aust Bar Rev* 63; and Legg M and Travers L, “Necessity is the Mother of Invention – the Adoption of Third Party Litigation Funding and the Closed Class in Australian Class Actions” (2009) 38 *Common Law World Review* 245.

¹² This is the name that is used in the United States, and has been loosely adopted around the world.

¹³ The Federal Court procedure is called a “representative proceeding” and is regulated under *Federal Court of Australia Act 1976* (Cth), Pt IVA. The Victorian procedure is called a “group proceeding” and is regulated under *Supreme Court of Victoria Act 1986* (Vic), Pt 4A. The Victorian procedure mirrors the Federal Court procedure.

¹⁴ See eg, *Uniform Civil Procedure Rules 2005* (NSW), rr 7.4 and 7.5.

¹⁵ *Federal Court of Australia Act 1976* (Cth), s 33C(1)(a). Compare *Philip Morris (Aust) Ltd v Nixon* (2000) 170 ALR 487 at 520-521 per Sackville J (with whom Spender and Hill JJ agreed) held that each applicant and all group members must have a claim against all respondents and *Bray v F Hoffman-La Roche Ltd* (2003) 130 FCR 317 at [243]-[248] per Finkelstein J (with whom Carr J agreed) which disputed this requirement and argued that it was not necessary for every group member to have claims against all respondents as this would require a proliferation of proceedings.

¹⁶ *Federal Court of Australia Act 1976* (Cth), s 33C(1)(b); *Zhang v Minister for Immigration, Local Government & Ethnic Affairs* (1993) 45 FCR 384 at 404 and *Guglielmin v Trescowthick (No 2)* (2005) 220 ALR 515 at [48].

¹⁷ *Federal Court of Australia Act 1976* (Cth), s 33C(1)(c) and *Wong v Silkfield Pty Ltd* (1999) 199 CLR 255 at 267.

¹⁸ *Federal Court of Australia Act 1976* (Cth), s 33D and *Symington v Hoechst Schering Agrevo Pty Ltd* (1997) 78 FCR 164 at 167. See also *Federal Court of Australia Act 1976* (Cth), s 33T which provides that a representative party may be substituted if they are not able to adequately represent the interests of the group members.

¹⁹ *Federal Court of Australia Act 1976* (Cth), s 33H and *Petrusevski v Bulldogs Rugby League Ltd* [2003] FCA 61 at [23] and [38].

action would be less efficient than separate proceedings or where it is “otherwise inappropriate that the claims be pursued by means of a representative proceeding”.²⁰

The procedural requirements for a valid class action and the availability of a procedure to discontinue a class action have not hampered the growth of investor class actions.²¹

The Australian class action procedure has three notable features that distinguish it from normal commercial litigation.

One notable feature of the Australian class action procedure is that it is an “opt out” system whereby notice is required to be given to all potential group members allowing them to opt out of the action if they wish.²² Judgment in the matter will bind all group members, except those that chose to opt out.²³ However, the Full Federal Court has held that a closed or limited group class action brought on behalf of some but not all putative group members was permissible based on its construction of the legislation and because the right to opt out was preserved, although there were practical impediments to actually opting out created by the litigation funding agreement under analysis.²⁴ The Full Federal Court also found that it is impermissible to allow group members to opt in to a class action already on foot.²⁵

The second notable feature is the settlement process is also different from ordinary commercial litigation. A representative proceeding may not be settled or discontinued without the approval of the court.²⁶ Further, unless the court is satisfied that it is just to do so, an application for approval of a settlement must not be determined unless notice has been given to group members.²⁷

The third notable feature is the alteration to the usual rule on costs. The usual costs rule in Australian litigation is that a losing party is liable for the other side’s costs, albeit only a portion of the costs actually incurred.²⁸ However, in the class action context the costs rule is limited to the representative party only and does not apply to other group members.²⁹

Class action drivers

A significant driver of class actions in Australia has been the use of litigation funding services.³⁰ Litigation funding services have been increasing in number and size in Australia in recent years and have been involved in several high profile investor class actions.³¹ The legality of litigation funders managing class actions was confirmed by the High Court in *Campbells Cash & Carry Pty Ltd v Fostif Pty Ltd* (2006) 229 CLR 386.

²⁰ *Federal Court of Australia Act 1976* (Cth), s 33N(1), *Bright v Femcare Ltd* (2002) 195 ALR 574 and *Multiplex Funds Management Ltd v P Dawson Nominees Pty Ltd* (2007) 164 FCR 275 at [13]-[15], [121]-[122].

²¹ Legg, n 3 at 692-693.

²² *Federal Court of Australia Act 1976* (Cth), ss 33J, 33X, 33ZB.

²³ *Federal Court of Australia Act 1976* (Cth), s 33ZB.

²⁴ *Multiplex Funds Management Ltd v P Dawson Nominees Pty Ltd* (2007) 164 FCR 275 at [44] and [194]-[195]. The group was defined as, inter alia, persons who “have, as at the commencement of this proceeding, entered a litigation funding agreement with International Litigation Funding Partners, Inc”.

²⁵ *Multiplex Funds Management Ltd v P Dawson Nominees Pty Ltd* (2007) 164 FCR 275 at [17] and [142].

²⁶ *Federal Court of Australia Act 1976* (Cth), s 33V. Section 33W deals with the settlement of a representative party’s individual claims. The Act allows for the representative party, with the leave of the court, to settle and withdraw from the litigation provided the court is satisfied that notice of the application has been given to group members.

²⁷ *Federal Court of Australia Act 1976* (Cth), s 33X(4).

²⁸ *Ruddock v Vadarlis (No 2)* (2001) 115 FCR 229 at [11], *Hughes v Western Australia Cricket Association (Inc)* [1986] ATPR 40-748 at 48,136; and Victorian Law Reform Commission, *Civil Justice Review*, Report 14 (2008) p 648 estimating that only 60-70% of costs are recovered.

²⁹ *Federal Court of Australia Act 1976* (Cth), s 43(1A). See also *Supreme Court Act 1986* (Vic), s 33ZD.

³⁰ Legg, n 3 at 704-705.

³¹ The largest litigation funder IMF (Australia) Ltd has been involved in over a dozen investor class actions including Telstra (settled), Aristocrat (settled), Downer EDI (settled), Ion Ltd (ongoing) Sons of Gwalia (settled), AWB Ltd (ongoing) and Village Life (settled): see further <http://www.imf.com.au> viewed 5 December 2009.

Litigation funding usually involves a commercial entity that contracts with one or more potential litigants. The funder pays the cost of the litigation (such as the lawyer's fees, disbursements, project management and claim investigation costs) and indemnifies the litigant against the risk of paying the other party's costs if the case fails.³² In return, if the case succeeds, the funder is reimbursed for the costs of the litigation, receives a percentage of the proceeds, and in some cases a project management fee. The percentage of the proceeds is agreed with the litigant, and is typically between 30-40% of the proceeds.³³ The percentage may also vary depending on the length of the case and the size of a litigant's claim.

Litigation funders are able to use the class action to aggregate losses and benefit from economies of scale to create a large but efficient claim.³⁴ Litigation funders have been able to bolster their business model through the use of a limited group class action as each group member has to be identified and can be required to accept the funding terms as a pre-condition of participation in the action. The litigation funder is better able to capture the class and prevent free-riding.³⁵

The profitability of litigation funding has led to one of the largest litigation funders in Australia (IMF Australia Ltd) being listed on the Australian Securities Exchange with assets of over \$64 million.³⁶ In the financial year 2008-2009, IMF derived a net income from litigation funding of over \$35 million.³⁷ There is currently more than \$1 billion being claimed in ongoing investor class actions.³⁸ IMF alone has a litigation funding book of over \$1 billion (although not all of these funded actions are investor class actions).³⁹ The profitability of litigation funding to date has encouraged a growing number of domestic and offshore litigation funders to enter the Australian class action market, which suggests that investor class actions will continue to increase in size and frequency.

Further, shareholders, large and small, are willing to sue because the combination of litigation funding and the change to the usual costs rule allows litigation with little downside. The shareholders must give up a share of their recovery and control over the litigation, but in return the litigation funder manages the litigation and relieves them of any risk of exposure to an adverse costs order that might otherwise deter the commencement of legal proceedings. The pooling of claims and loss of control over the management of the claim led the majority of the Full Federal Court to rule that litigation funding could be characterised as a managed investment scheme, with the resulting requirement that those involved in litigation funding establish registered managed investment schemes.⁴⁰ At the time of

³² For an analysis of litigation funding in Australia see Legg M, "Institutional Investors and Shareholder Class Actions: The Law and Economics of Participation" (2007) 81 ALJ 478; and Legg M, "Security for Costs the Solution to Litigation Funding", *The Australian Financial Review* (13 November 2009) p 42.

³³ Standing Committee of Attorneys-General, *Litigation Funding in Australia* (May 2006) pp 4 and 7; and Coope P, *Litigation Funding* (Paper presented at The Australian Institute of Judicial Administration Conference – Affordable Justice, Adelaide, 15-17 September 2006) 3.

³⁴ Legg, n 3 at 704.

³⁵ Cashman P, "Class Actions on Behalf of Clients: Is this Permissible?" (2006) 80 ALJ 738 at 750: "What was of paramount concern to the funder of the litigation was a requirement that all those who were to be the beneficiaries of the financial assistance should contractually agree to pay part of the proceeds to the funder in the event that they succeed in recovering damages".

³⁶ See IMF (Australia) Ltd, 2008-2009 Annual Report, available from <http://www.imf.com.au> viewed 5 December 2009.

³⁷ IMF, 2009 Full Year Annual Report. A substantial component of this net income arose from the settlement of the Aristocrat class action for \$144.5 million, the largest class action in Australian history: for a discussion of this matter see Legg, "The Aristocrat Leisure Ltd Shareholder Class Action Settlement" (2009) 37 ABLR 399. The previous record for settlement of investor class actions was *King v GIO* which generated a settlement in excess of \$110 million.

³⁸ Centro alone is likely to exceed that amount. It is currently defending three class actions that have been estimated to be for claims of \$1 billion. See further below Pt IV "Case study: Centro Property Group".

³⁹ IMF Australia, 2009 Full Year Annual Report, n 37.

⁴⁰ *Brookfield Multiplex Ltd v International Litigation Funding Partners Pty Ltd* [2009] FCAFC 147.

writing, the Australian Securities and Investments Commission had agreed to give litigation funders temporary exemptions from such requirements pending a regulatory review by the Commonwealth.⁴¹

The value of investor class actions

Investor class actions have generated extensive debate across the world, with equal numbers of advocates and detractors. In the Centro class action, Finkelstein J summarised the function of securities class actions as follows:⁴²

It is often said that these actions promote investor confidence in the integrity of the securities market. They enable investors to recover past losses caused by the wrongful conduct of companies and deter future securities laws violations. According to the United States Supreme Court, they provide “a most effective weapon in enforcement” of the securities laws and are a “necessary supplement to [Securities Exchange] Commission action”.

Supporters of the investor class action procedure also argue that they provide an important access to justice tool which allows plaintiffs with relatively⁴³ small claims to protect their legal rights.⁴⁴ In the corporate law arena, class actions typically involve claims for the payment of compensation to investors who have been misled by inaccurate disclosure practices.

The combination of access to justice and private enforcement rationale has seen the class action promoter referred to as the “private attorney general” who seeks out contraventions and ensures they do not go unnoticed leading to greater deterrence.⁴⁵ As contraventions are more likely to result in litigation and its related costs, including payment of compensation and reputational effects, corporations will take greater care not to contravene the law.⁴⁶ This should provide better information to the capital markets and lower the overall cost of equity capital because of greater confidence in the integrity of information disclosed to the market and the pricing of both debt and equity securities based on that information.⁴⁷ However, such positive externalities depend upon the credible threat of enforcement action. For private actions, issues such as the assets held by the company, availability and sufficiency of insurance and ease of proving a contravention will be relevant. It is trite to note that private class action providers will not have sufficient economic incentives to pursue all breaches of disclosure laws. For public enforcement actions by the Australian Securities and Investments Commission (ASIC), issues such as the severity of the contravention, availability of alternative sanctions and decisions of appropriate resource allocation will influence the credibility of the threat of legal action to enforce disclosure provisions.⁴⁸

⁴¹ Australian Securities and Investment Commission (ASIC), *ASIC Grants Transitional Relief from Regulation for Funded Class Actions* (Media Release, 09-218MR).

⁴² *Kirby v Centro Properties Ltd* (2008) 253 ALR 65; [2008] FCA 1505 at [8] citing *Bateman Eichler, Hill Richards Inc v Berner* 472 US 299, 310 (1985) and *J I Case Co v Borack* 377 US 426, 432 (1964).

⁴³ The increasing cost of commercial litigation has rendered small claims under \$100,000 to be not worth litigating. The problem in Australia is exacerbated by the costs follow the event rule: see further Taylor P, Elms E, Bellew G, Meek M, and Bartush-Peek T, *Ritchie's Uniform Civil Procedure*, (LexisNexis Butterworths, 2005) at [r 42.1] General rule that costs follow the event.

⁴⁴ The legal rights that may be used to support a securities class action are outlined below.

⁴⁵ See Hensler D, Pace N, Dombey-Moore B, Giddens E, Gross, J, and Moller E, *Class Action Dilemmas – Pursuing Public Goals for Private Gain* (RAND Institute for Civil Justice, 2000) pp 69-72.

⁴⁶ Dutta S and Nelson J, *Shareholder Litigation and Market Information: Effects of the Endorsement of the Fraud-on-the-Market Doctrine on Market Information* (March 1997) p 4, <http://www.ssrn.com/abstract=69036> viewed 30 December 2009: “firms have strong incentives to warn external parties of earnings surprises, especially when faced with large, negative earnings surprises. Failure to do so increases the risk of shareholder litigation brought under Rule 10b-5”.

⁴⁷ See Bilski A and Brown P, “Sons of Gwalia Versus Shareholder Subordination: Fairness Versus Efficiency” (2008) 26 C&SLJ 93, who also note that the availability of investors class actions during insolvency is also likely to increase debt finance costs over time. See also Brown C and Davis K, “Credit Markets and the Sons of Gwalia Judgement” (2006) 13(3) *Agenda* 239.

⁴⁸ For a discussion of public enforcement of disclosure laws see Zandstra A, Harris J and Hargovan A, “Widening the Net: Accessorial Liability for Continuous Disclosure Contraventions” (2008) 22 AJCL 51; Welsh M, “Enforcing Contraventions of the Continuous Disclosure Provisions: Civil or Administrative Penalties” (2007) 25 C&SLJ 315.

Shareholder class actions are also advocated on the basis that they promote corporate governance by allowing for the enforcement of statutory requirements such as continuous disclosure and prohibitions on misleading conduct.⁴⁹ Moreover, disclosure laws that are enforced benefit securities markets through encouraging managers to provide more reliable information to market participants.⁵⁰ This in turn promotes investor confidence. Further, enforcement measures help mitigate agency costs involved in aligning the interests of management with those of the outside shareholders.

Although investor class actions produce some benefits, there are also forceful criticisms made against the procedures. There is little doubt that they are time consuming and extremely costly. This was seen recently with the settlement by Telstra of its investor class action for \$5 million. Telstra explained its settlement on the basis that to contest the matter would have cost considerably more. The settlement was reported to have resulted in \$1.25 million being paid to the applicants' lawyers and about \$3.75 million being shared by up to 29,000 investors.⁵¹

Investor class actions may also involve the problem of pocket shifting wealth transfers from one group of shareholders to another. Investor class actions, even unsuccessful ones, invariably generate substantial costs for the defendant. Part of this amount may come from the defendant's insurer, and the remainder will be drawn from earnings, which could have been used to improve the business or distributed to shareholders. Therefore, a class action results in current or former shareholders (the plaintiffs) obtaining payment from the current shareholders of the defendant company.⁵² This cost does not include the additional, and potentially more harmful, cost of distracting management from their core responsibility of running the business.⁵³ Lastly, the class action may also result in a substantial drop in the company's share price.⁵⁴

In view of the extensive costs that are incurred as a result of investor class actions, it is a legitimate question to ask who benefits from the proceedings aside from legal advisors and litigation funders? This issue will be discussed further below.

The range of investor class action claims

Investor class actions may rely on a number of causes of action to support their claim. The most commonly used provisions involve misleading or deceptive conduct in relation to financial services or a financial product,⁵⁵ defective disclosure documents used in corporate fundraising⁵⁶ and failure to comply with the continuous disclosure rules of the ASX.⁵⁷

⁴⁹ Spender P, n 11 at 127 and Murphy B and Cameron C, "Access to Justice and the Evolution of Class Action Litigation in Australia" (2006) 30 MULR 399 at 404-405.

⁵⁰ Thompson R and Sale H, "Securities Fraud as Corporate Governance: Reflections Upon Federalism" (2003) 56 *Vanderbilt Law Review* 859, 861 and Dutta and Nelson, n 46, p 31 finding that an easing of the requirements for commencing securities class actions in the United States resulted in increased and more timely disclosure of "bad news".

⁵¹ *Taylor v Telstra Corp Ltd* [2007] FCA 2008 at [34]-[37]; Drummond M and Priest M, "Telstra Settlement under Court Scrutiny", *The Australian Financial Review*, (16 November 2007) p 57; Moran S, "Blackburn Slams Slaters over Telstra", *The Australian* (16 November 2007) p 37.

⁵² Legg, n 32 at 482.

⁵³ Legg, n 37 at 410.

⁵⁴ See Thakor A, *The Unintended Consequences of Securities Litigation* (Research paper, Olin School of Business, Washington University, St Louis, October 2005) pp 4-5; and Pritchard and Ferris, "Stock Price Reactions to Securities Fraud Class Actions under the Private Securities Litigation Reform Act" (October 2001) *Michigan Law and Economics Research Paper No 01-009*, p 3, <http://www.ssrn.com/abstract=288216> viewed 30 December 2009.

⁵⁵ *Corporations Act 2001* (Cth), ss 1041H, 1041I, 1325. See also *Australian Securities and Investments Commission Act 2001* (Cth), ss 12DA, 12GF.

⁵⁶ *Corporations Act 2001* (Cth), ss 729, 1325.

⁵⁷ *Corporations Act 2001* (Cth), ss 674, 1325.

There are also grounds to pursue action against directors and individuals who are “involved” in the contravention.⁵⁸ However, these provisions have not been traditionally used in class actions due to the more limited assets available when suing natural persons.⁵⁹ Even with effective directors’ and officers’ insurance coverage, the amount of coverage is unlikely to match the multimillion (or even hundreds of millions) dollar lawsuits currently underway.⁶⁰

Lastly, ASIC may also bring representative proceedings to pursue compensation for investors.⁶¹ This procedure has not been frequently used by ASIC, with the exception of the recent Westpoint collapse where ASIC has taken several actions to recover compensation on behalf of investors.⁶²

The link between investor class actions and corporate rescue

Considered in isolation, investor class actions may seem to have little connection with corporate rescue laws. Of course, a sufficiently large investor class action may, if successful, put significant financial strain on a company’s profitability, which may result in the defendant company becoming involved in a corporate rescue attempt.⁶³ Ironically, in the United States, defendants have attempted to use the class action to stave off possible bankruptcy by seeking to bind all claimants through a class action settlement and achieve “global peace”.⁶⁴ In Australia, the courts have drawn a distinction between using schemes of arrangement and deeds of company arrangement to implement releases against third parties.⁶⁵

Aside from this somewhat limited situation, the relevance of investor class actions to corporate rescue attempts arises from the implications of the High Court’s *Sons of Gwalia* decision in early 2007.⁶⁶ That case has received extensive discussion in the media and in academic commentaries and

⁵⁸ *Corporations Act 2001* (Cth), ss 79, 674(2A). See the recent settlement by the directors of Sons of Gwalia, who reportedly paid several million dollars towards a settlement by the company: Evers J, “Gwalia Board’s \$53m Hit”, *The Australian Financial Review* (16 April 2009) p 1.

⁵⁹ For a discussion of accessorial liability see Zandstra, Harris and Hargovan, n 48.

⁶⁰ Of course, parties may choose to settle actions for less than the amount claimed: see eg, the settlement reached in respect of alleged defective disclosure by Sons of Gwalia, where the directors reportedly paid several million dollars towards the settlement figure combined with an approximately \$53 million insurance payment from the Australian Industry Group (AIG): see ABC Lateline Business transcript (17 April 2009) <http://www.abc.net.au/lateline/business/items/200904/s2545184.htm> viewed 30 December 2009.

⁶¹ *Australian Securities and Investments Commission Act 2001* (Cth), s 50. See further Austin J, “Does the Westpoint Litigation Signal a Revival of the ASIC s 50 Class Action?” (2008) 22 AJCL 8.

⁶² For more information concerning ASIC’s actions on behalf of investors see: <http://www.asic.gov.au> viewed 30 December 2009.

⁶³ See *In re Rhone-Poulenc Rorer, Inc* 51 F.3d 1293, 1300 (7th Cir 1995) and *Castano v American Tobacco Co*, 84 F.3d 734, 746 (5th Cir 1996). In the United States the link between class action litigation and bankruptcy is best illustrated by the asbestos cases where 63 asbestos related bankruptcies took place between 1982 and 2005, including the industry’s largest firm Johns-Manville Corp, as a result of litigation that was characterised by numerous class action proceedings. See Coffee J, “Class Wars: The Dilemma of the Mass Tort Class Action” (1995) 95 *Columbia Law Review* 1343 at 1386 and Stengel J, “The Asbestos End-Game” (2006) 62 *New York University Annual Survey of American Law* 223 at 260, 265. In the securities class action area the threat or existence of a class action has not been linked with bankruptcy, rather, such class actions usually settle for close to the amount of insurance carried by the corporation. See Cox J D, “Making Securities Fraud Class Actions Virtuous” (1997) 39 *Arizona Law Review* 497 at 512 “approximately 96% of securities class action settlements are within the typical insurance coverage, with the insurance proceeds often being the sole source of settlement funds”.

⁶⁴ Silver C, “‘We’re Scared to Death’: Class Certification and Blackmail” (2003) 78 *New York University Law Review* 1357 at 1405, fn 203 referring to attempts to prevent bankruptcy in relation to class actions arising from asbestos, silicone breast implants and hip implants.

⁶⁵ Compare *City of Swan v Lehman Brothers Australia Ltd* (2009) 260 ALR 199; [2009] FCAFC 130 (a Deed of Company Arrangement (DOCA) may not include a release against third parties) with *Re Opes Prime Stockbroking Ltd* (2009) 73 ACSR 385; [2009] FCA 813 (a scheme of arrangement could include third party releases). It should be noted that the *City of Swan* case has been given special leave to appeal by the High Court.

⁶⁶ *Sons of Gwalia Ltd v Margaretic* (2007) 231 CLR 160.

need not be discussed here.⁶⁷ However, the direct implication of that decision is that investor class actions, provided they rely upon general statutory causes of action to support their damages claims, are able to be maintained even when a company enters external administration as they are not bound by s 563A which subordinates claims by members in their capacity as such. In such a situation, the plaintiffs take on the role of contingent creditors of the company in external administration and the plaintiffs are able to submit proofs of debt (provided their claim is fairly estimated)⁶⁸ and participate in creditors meetings and distributions. Unlike other contingent claims,⁶⁹ investor class actions may include classes of plaintiffs in the thousands or tens of thousands each of whom will be claiming different amounts and will need to prove causation in respect of their pure economic loss.⁷⁰ Although proving causation has been difficult in several investor actions, the claim (whether ultimately successful or not) generates significant administrative challenges, which potentially jeopardise corporate rescue measures. This will be discussed further below.

In order to understand the potential impact of investor class actions on corporate rescue proceedings, it is important to outline the nature and role of corporate rescue laws.

PT III – THE ROLE AND VALUE OF CORPORATE RESCUE PROCEDURES

The rescue culture

The past 30 years have seen an increasing focus in corporate insolvency laws around the world to build and maintain a culture of corporate rescue rather than a culture of liquidating companies in financial distress. The usual goal of corporate insolvency laws is to terminate the business of an insolvent company, sell the assets and return the proceeds to satisfy (at least partially) the debts owed by the company. This goal is traditionally pursued under a liquidation or winding up procedure where the rescue of the business is not the primary goal.⁷¹

In contrast to the goal of terminating the business and selling all of its assets, corporate rescue procedures are aimed at saving all or part of the business. This goal is aimed at “revival of companies on the brink of economic collapse and the salvage of economically viable units to restore production capacity, employment and the continued rewarding of capital and investment”.⁷²

The corporate rescue culture may be manifested in both formal and informal corporate rescue procedures.⁷³ Informal rescue procedures involve the renegotiation of the debtor company’s contractual obligations and provide the benefits of low costs and flexibility. The weakness of informal procedures is that they do not provide comprehensive protection in respect of claims against the debtor company’s assets during the reorganisation. Usually, major creditors (both secured and unsecured) will be involved in the renegotiation (or workout as it is sometimes called) and will sign a “standstill” agreement which will limit the enforcement of their rights during the workout. However, this does not bind non-parties to the agreement and dissenting creditors or aggrieved investors who may seek court

⁶⁷ See eg, Harris J and Hargovan A, “Sons of Gwalia: Navigating the Line Between Membership and Creditor Rights in Corporate Insolvencies” (2007) 25 C&SLJ 7; Hargovan A and Harris J, “The Shifting Balance of Shareholders’ Interests in Insolvency: Evolution or Revolution?” (2007) 31 MULR 591; Bilski and Brown, n 47; Boros E, “Shareholder litigation after Sons of Gwalia Ltd v Margaretic” (2008) 26 C&SLJ 235. The Corporations and Markets Advisory Committee (CAMAC) did not recommend overturning the case through legislation in its final report, *Shareholder Claims Against Insolvent Companies: Implications of the Sons of Gwalia Decision* (December 2008), which is available from the CAMAC website: <http://www.camac.gov.au> viewed 5 December 2009.

⁶⁸ *Corporations Regulations 2001* (Cth), reg 5.6.23(2).

⁶⁹ It is accepted that mass tort claims are an exception to this statement.

⁷⁰ For a discussion of proof of causation in securities class actions see Grave D, Watterson L and Mould H, “Causation, Loss and Damage: Challenges for the New Shareholder Class Action” (2009) 27 C&SLJ 483 and Legg, n 37 at 401-404.

⁷¹ This is recognised in *Corporations Act 2001* (Cth), s 477(1)(a) which provides the liquidator with the power to manage the business only to the extent necessary for the beneficial disposal of the business.

⁷² Omar P, “Thoughts on the Purpose of Corporate Rescue” (1997) 12 JIBL 127 at 127.

⁷³ For a detailed discussion of informal workout procedures see Buljevich E (ed), *Cross-Border Debt Restructurings* (Euromoney, 2005).

action against the company during the workout. The effect of these proceedings may well be to destroy the chances of a corporate rescue, and provide sub-optimal returns on the assets of the debtor company. This problem is discussed further in Pt IV.

A formal rescue procedure is one regulated by statute and enforced by the courts. The imposition of formal proceedings will invariably generate higher costs through formal appointments, collective creditors meetings and possible court proceedings. Formal proceedings are likely to damage the debtor's business goodwill as formal appointments receive publicity and attract the stigma of a business "failure". A formal appointment may also trigger automatic termination clauses in key contracts used by the company (ipso facto clauses), which could severely limit the ability of the company to continue trading. However, formal rescue proceedings also offer the benefit of mechanisms to protect the company and its assets during the rescue attempt by the introduction of a moratorium on claims against the company.⁷⁴ The moratorium provides the company with breathing room to develop an appropriate restructuring plan, usually implemented with a deed of company arrangement under Pt 5.3A Div 10. This will hopefully maximise the value of the business and provide a better return than a race to the assets by the creditors and the consequential liquidation of the company.

An effective rescue culture will have both informal and formal legal processes that work co-operatively to facilitate attempts to maximise the value of the business in financial distress. Both of these procedures need to work together, and the conduct of each is done in the shadow of liquidation and a potential fire sale of the assets, a situation where usually everyone is worse off.

Advantages and disadvantages of corporate rescue regimes

Corporate rescue regimes seek to maximise the value of the business operated by the company in financial difficulty. There is thus, a distinction between the business and the company it operates.⁷⁵ The actual company running the business may be significantly altered during a corporate rescue process (more commonly referred to as a restructure or reorganisation in Australia). The goal of corporate rescue laws is to preserve the value of the business and thereby protect employment and maximise creditor returns through a viable rescue strategy designed to preserve the profitable components of the business. This may involve selling some or all of the business in a trade sale, a reorganisation of the internal operations (including disposal or termination of non-core business lines and cost cutting) and/or a rescheduling of major debt obligations.

Preserving the profitable components of a business will help maximise the value returned to creditors through:⁷⁶

- preserving business goodwill and customer relationships (and hopefully future profits);
- realising the value of work in progress and book debts; and
- avoiding "fire sale" asset valuations that occur during liquidator sales.

There are also indirect benefits to the economy through maintaining competition levels,⁷⁷ preserving service agreements to related industries,⁷⁸ and continuing tax revenues from the trading entity.

There are however, counter-arguments to the value of corporate rescue regimes.⁷⁹ A number of scholars, particularly in the United States, have been highly critical of the rescue culture. However,

⁷⁴ *Corporations Act 2001* (Cth), ss 440A – 440D.

⁷⁵ See Frisby S, "In Search of a Rescue Regime: The Enterprise Act 2002" (2004) 67 *Mod LR* 247 at 248-249.

⁷⁶ Rajak H, "Rescue Versus Liquidation in Central and Eastern Europe" (1998) 33 *Texas International Law Journal* 157 at 162.

⁷⁷ The collapse of insurance company HIH and its dramatic impact on the insurance market in NSW, particularly in professional indemnity, public liability and home builder's warranty insurance, is an excellent example.

⁷⁸ Interruptions to car production in Victoria as a result of the collapse of component manufacturer Ion Ltd are a good example.

⁷⁹ For an early Australian critique: Lightman K, "Voluntary Administration: The New Wave or the New Waif in Insolvency Law?" (1994) 2 *Insolv LJ* 59.

this argument is largely concerned with the particular features of the United States corporate rescue procedure in Ch 11 of the *Bankruptcy Code 1978* and fears about its potential abuse by companies.⁸⁰

There is also the potential danger that corporate rescue regimes will delay what may well be the inevitable demise of the business. It is clear that not all ailing businesses can, or should, be saved.⁸¹ There may well be valid economic reasons to liquidate a business (such as fundamental structural shifts in the economy that render the company's business unsustainable), and a delay to do so merely extends the inefficient use of scarce resources. Furthermore, the use of professional "turnaround experts" will generate potentially large costs for the business seeking to be reorganised which may not be justified if the company should have been liquidated on the basis of economic structural failure rather than a short term financial liquidity problem. Lastly, corporate rescue laws may lead to increased credit costs to compensate for delays in allowing creditors to strictly enforce their legal rights to repayment.

Despite the potential dangers of abusing corporate rescue laws to delay the inevitable, the impetus to instil a corporate rescue culture is increasing around the world and shows no signs of abating. What began (most famously) in the United States with the addition of Ch 11 of the *Bankruptcy Code* in 1978 then spread to the United Kingdom where the landmark *Cork Report* led to the introduction of an administration regime in the *Insolvency Act 1986* (UK).⁸² In more recent times, international bodies such as the World Bank have pushed for the implementation of formal corporate rescue regimes around the world.⁸³

Australia's formal corporate rescue regime is contained in Pt 5.3A of the *Corporations Act 2001* (Cth) (voluntary administration). This was introduced following recommendations from the Australian Law Reform Commission's *General Insolvency Inquiry* (the Harmer Report). In recommending the introduction of voluntary administration, the Harmer Report noted that pre-existing corporate insolvency laws (particular schemes of arrangement and official management) were "overly conservative" and had "very little emphasis on the possibility of ... saving a business and preserving job prospects".⁸⁴

It is now appropriate to examine the scope of voluntary administration as a formal corporate rescue regime.

The scope of voluntary administration

The purpose of voluntary administration is stated clearly in s 435A of the *Corporations Act* which provides:

The object of [voluntary administration] is to provide for the business, property and affairs of an insolvent company to be administered in a way that:

- (a) maximises the chances of the company, or as much as possible of its business, continuing in existence; or

⁸⁰ The debate concerning the relative merits (both economic and non-economic) of corporate rescue procedures is extensive. For a sample of the debate see: Baird D, "The Uneasy Case for Corporate Reorganisation" (1986) 15 *Journal of Legal Studies* 127; Bradley M and Rosenzweig M, "The Untenable Case for Chapter 11" (1992) 101 *Yale LJ* 1043; Warren E, "The Untenable Case for Repeal of Chapter 11" (1992) 102 *Yale LJ* 437; Jackson, n 2, Ch 9; Sarra J, *Creditor Rights and the Public Interest* (University of Toronto Press, 2003). For an overview of the literature see Finch V, *Corporate Insolvency Law* (2nd ed, Cambridge University Press, 2009), Ch 2.

⁸¹ Frisby, n 75 at 248.

⁸² It is recognised that the Ch 11 reorganisation procedure has a long heritage that goes back at least to railroad reorganisations by JP Morgan and others in the 19th Century: see the historical account in Skeel D, *Debt's Dominion: A History of Bankruptcy Law in America* (Princeton University Press, 2003). It is also recognised that other countries had formal reorganisation laws much earlier than 1978: see *Companies' Creditors Arrangement Act 1985* RSC C-36 (Canada), which was introduced during the 1930s: see Sarra J, *Rescue! The Companies Creditors Arrangement Act* (Thomson Carswell, 2007). For a discussion of the historical origins of corporate rescue laws in Britain see: Anderson C, "Finding the Background of Part 5.3A of the Corporations Law" (1999) 10 *AJCL* 107.

⁸³ World Bank, *Principles and Guidelines for Effective Insolvency and Creditors Rights Systems* (April 2001).

⁸⁴ Australian Law Reform Commission, *General Insolvency Inquiry*, 1988, Vol 1 at [52] (hereafter "Harmer Report").

- (b) if it is not possible for the company or its business to continue in existence – results in a better return for the company's creditors and members than would result from an immediate winding up of the company.

Voluntary administration has now been in operation for 16 years, and is regarded by the business community as being largely successful. During the past 16 years there have been several official inquiries involving insolvency law and none have suggested that the procedure be repealed. Indeed, a suggestion to move towards a procedure similar to Ch 11 in the United States has been flatly rejected.⁸⁵

The voluntary administration procedure has been discussed and critiqued extensively in the past 16 years, and readers of the *Journal* are no doubt familiar with the scope of the debate. This article does not seek to critically analyse the strengths or weaknesses of voluntary administration, but rather to highlight external forces that may reduce the efficacy of the procedure as an important part of the legal regime supporting corporate rescue attempts through the use of both formal and informal procedures. Therefore, we need only provide an overview of voluntary administration and may focus on the corporate rescue features of the procedure.⁸⁶

An effective corporate rescue regime will provide an efficient means to initiate the procedure that involves as little cost and delay as possible.⁸⁷ This is particularly important given the damaging effects that ipso facto termination clauses may have on the business if delay is caused by the need to seek judicial or creditor approval prior to obtaining the protection of the moratorium against creditors' claims.⁸⁸ Voluntary administration achieves this by allowing an administrator to be appointed without the need for court approval.⁸⁹

In addition, an effective corporate rescue regime will provide a moratorium that confers protection to give the company and its creditors sufficient time to develop a viable reorganisation plan. Voluntary administration achieves this by imposing a moratorium on all claims against the debtor company for the duration of the administration.⁹⁰ Claims by secured creditors are an exception to this moratorium, although only creditors with an enforceable security over "the whole or substantially the whole of the company's property" may take enforcement action, and may only do so within the first 13 business days of the administration.⁹¹ The power to deal with the company's assets is restricted to the administrator and any person acting with the written permission of the administrator or the court,⁹² although the court is reluctant to allow a creditor to unduly interfere with the process of voluntary

⁸⁵ Parliamentary Joint Committee on Corporations and Financial Services, *Corporate Insolvency Laws: A Stocktake* (June 2004) at [5.75], available at <http://www.aph.gov.au> viewed 5 December 2009.

⁸⁶ For a detailed analysis of voluntary administration see Anderson and Morrison D, *Crutchfield's Voluntary Administration* (Lawbook Co, online service, 2009); O'Donovan J, *Company Receivers and Administrators* (Lawbook Co, online service, 1989).

⁸⁷ See further Anderson C, "Commencement of the Part 5.3A Procedure: Some Considerations from an Economics and Law Perspective" (2001) 9 *Insolv LJ* 4.

⁸⁸ It is interesting to note that the power to appoint an administrator in England was originally only given to the court under the *Insolvency Act 1986* (UK) but was expanded in 2002 to include appointment by the company's directors: *Insolvency Act 1986* (UK), Sch B1, s 22. See further Keay A, "The Enterprise Act 2002: Pioneering a Brave New World in Insolvency Law in the United Kingdom?" (2003) 11 *Insolv LJ* 163.

⁸⁹ See *Corporations Act 2001* (Cth), ss 436A (appointment by the company), 436B (appointment by a liquidator, although court or creditor permission is required if a liquidator wishes to appoint themselves as administrator), 436C (appointment by a secured creditor).

⁹⁰ *Corporations Act 2001* (Cth), s 440D.

⁹¹ *Corporations Act 2001* (Cth), s 441A. Other secured creditors may only continue with existing enforcement proceedings that were commenced prior to the administrator's appointment: s 441B. The ability to enforce security interests may continue with the approval of the administrator or the court: s 440B.

⁹² *Corporations Act 2001* (Cth), ss 437D, 440B.

administration if such conduct would prejudice the potential for achieving the objectives set out in s 435A.⁹³ The moratorium also extends to enforcement action by owners and lessors of property held or used by the company.⁹⁴

Voluntary administration places the control over the future of the debtor company squarely on the shoulders of the creditors. Creditors are involved in two key meetings, the first within eight business days of the appointment, where a committee of creditors may be formed and the administrator may be replaced by the creditors' meeting.⁹⁵ In the second and final meeting,⁹⁶ the creditors decide the company's future, which will involve:⁹⁷

- (a) terminating the administration and returning the company to management;
- (b) placing the company into a creditors' voluntary liquidation; or
- (c) entering a deed of company arrangement.

The creditors' choice is informed by a report on the company's position given by the administrator.⁹⁸

Voluntary administration is not designed to be the primary corporate rescue mechanism in Australia. It is designed to be an efficient process that will facilitate corporate rescue,⁹⁹ which is typically implemented by a deed of company arrangement (DOCA).¹⁰⁰ A DOCA is essentially a compromise between the debtor company and its creditors,¹⁰¹ which will typically involve an extension of the moratorium (at least against unsecured creditors)¹⁰² and a compromise on the timing or amount of debt repayment. A DOCA may also involve a substantial reorganisation of the debtor company's corporate and business structure, including asset sales and the sell off of "non-core" units. Highly valuable business units may also be spun off to generate funds to repay debts under the deed. Recent major corporate rescues involving Pasminco and Sons of Gwalia involved significant capital reorganisations and spin offs of business units into newly listed entities that continue to trade today.¹⁰³

⁹³ The detailed case law on applications for exceptions to the general moratorium under s 440D is instructive in this regard: see *Foxcraft v The Ink Group Pty Ltd* (1994) 15 ACSR 203; *Brian Rochford Ltd v Textile Clothing & Footwear Union (NSW)* (1998) 47 NSWLR 47.

⁹⁴ *Corporations Act 2001* (Cth), s 440C.

⁹⁵ *Corporations Act 2001* (Cth), s 436E.

⁹⁶ The final creditors meeting is typically held within five business days before or after the convening period which is typically 20 business days starting on the next business day after the administrator was appointed: *Corporations Act 2001* (Cth), s 439A. An extension of time may be sought from the court during the convening period: s 439A(6).

⁹⁷ *Corporations Act 2001* (Cth), s 439C.

⁹⁸ *Corporations Act 2001* (Cth), ss 438A, 439A.

⁹⁹ A recent empirical study of 335 voluntary administrations found that the average return to creditors was only slightly above 10% and for administrations that specifically recommended a DOCA the average return to creditors was less than 15%: Herzberg A, Bender M and Gordon-Brown L, "Characteristics of Companies in Voluntary Administration" (2009) 61 *Keeping Good Companies* 260.

¹⁰⁰ See *Corporations Act 2001* (Cth), Pt 5.3A, Divs 10 – 11. The deed must be executed by the company within 15 business days of the final creditors' meeting approving the deed: *Corporations Act 2001* (Cth), s 444B. For a detailed discussion of transition from voluntary administration into a DOCA see Anderson C, "Ending a Means to an End: Transition from the Voluntary Administration Process to a Deed of Company Arrangement or Liquidation" (2004) 23 *University of Tasmania Law Review* 15.

¹⁰¹ It should be noted however, that the creditors are not a party to the DOCA, and despite its name, the DOCA is not a deed in the general law sense of the term: *MYT Engineering Pty Ltd v Mulcon Pty Ltd* (1999) 195 CLR 636.

¹⁰² Secured creditors and owners and lessors of property used by the company are not generally bound by a DOCA, although the court may make an order limiting their rights to ensure that the objects of the DOCA can be achieved provided their interests are protected: *Corporations Act 2001* (Cth), ss 444D, 444F. See further *Re Strazdins; DNPW Pty Ltd v Birch Carroll & Coyle Ltd* (2009) 72 ACSR 563; [2009] FCA 731.

¹⁰³ For a discussion of the Pasminco workout see Walker I, "Voluntary Administration Leading to a Deed of Company Arrangement", in Olivares-Caminal R, *Expedited Debt Restructuring: An International Comparative Analysis* (Wolters Kluwer, 2007).

In recent times, DOCAs have also been used to create a “creditors’ trust” that allows the company to leave administration relatively quickly while creditor debts are converted into interests as beneficiaries of a trust.¹⁰⁴

A DOCA offers significant advantages as a corporate rescue tool, including:

- no court approval is required to implement a DOCA;
- approval of the DOCA requires only an ordinary resolution of the creditors and binds all unsecured creditors even if they did not vote;
- voting on a DOCA does not require the separation of creditors into separate classes, which is a continuing problem in the use of schemes of arrangement.¹⁰⁵

Although voluntary administration and resulting DOCAs do not require court approval, the court retains a supervisory jurisdiction over the process and has extensive powers to improve the working of the administration and DOCA.¹⁰⁶ For example, the court may terminate a DOCA where inadequate information was provided to the creditors at the final meeting or where the DOCA operates in an unfair or oppressive manner.¹⁰⁷ The company’s creditors may also vary or terminate a DOCA.¹⁰⁸ If the DOCA is terminated by the court or the creditors, the company will enter a creditors’ voluntary liquidation.¹⁰⁹ A DOCA may also terminate once it has achieved its purpose,¹¹⁰ and the company may be returned to the control of management.

Regrettably there are no official statistics as to what proportion of companies entering voluntary administration end up in a DOCA.¹¹¹ Nor are there statistics to show what outcomes are generated from the DOCAs that are entered into. This is clearly an area where more empirical research would provide valuable insights into the outcomes of corporate rescue attempts.¹¹²

PT IV – EVALUATING THE PROBLEM

Developing a culture of corporate rescue

An effective corporate rescue regime needs more than a range of available formal and informal procedures. Perhaps the most important component is the confidence that the business community (particularly the corporate finance community) has in the rescue process. If a large secured lender has no confidence in the prospects of developing a feasible reorganisation, liquidation will almost certainly result regardless of whether a voluntary administration proceeds it or not. This is because the holder of an enforceable charge which covers at least a substantial proportion of the debtor company’s assets can effectively remove those assets from the reorganisation picture by appointing a receiver and selling the secured assets, thereby destroying the rescue attempt. The appointment of a receiver is often seen as the death knell of the company.

Implementing a corporate rescue culture requires a change in perspective from a creditor driven model of property rights enforcement to one of cooperation and compromise among stakeholders

¹⁰⁴ See further Australian Securities and Investments Commission (ASIC) *External Administration: Deeds of Company Arrangement Involving a Creditors’ Trust: A Guide for Registered Liquidators Appointed under Part 5.3A*, Regulatory Guide 82 (May 2005); Cooper P, “Understanding Creditors’ Trusts” (2008) 8 *Insolv* LB 98.

¹⁰⁵ For a discussion of this issue, see Renard I R and Santamaria J G, *Takeovers and Reconstructions in Australia* (LexisNexis, subscription service) at [1519].

¹⁰⁶ See *Corporations Act 2001* (Cth), s 447A. For a discussion of s 447A, see Harris J, “The Constitutional Basis of S 447A: Is it a Power Without Limit?” (2006) 14 *Insolv* LJ 135. The recent decision in *City of Swan v Lehman Brothers Australia Ltd* (2009) 260 ALR 199; [2009] FCAFC 130 contains a detailed discussion of the operation of the DOCA provisions in Pt 5.3A.

¹⁰⁷ *Corporations Act 2001* (Cth), s 445D.

¹⁰⁸ *Corporations Act 2001* (Cth), ss 445A (variation), 445C (termination), 445CA (limitations on creditor termination of deeds).

¹⁰⁹ *Corporations Act 2001* (Cth), s 446B.

¹¹⁰ *Corporations Act 2001* (Cth), s 445C(c).

¹¹¹ The recent study by Herzberg, Bender and Gordon-Brown showed that less than 30% of companies in voluntary administration entered a DOCA.

¹¹² For further discussion of this problem see Murray M, “The Dark Figures of Insolvency” (2009) 10 *Insolv* LJ 7.

(particularly creditors). The prevailing mood must be one of shared responsibility.¹¹³ The apprehension of one or more groups being unwilling to compromise may cause other stakeholders to stand on their legal rights and push for liquidation, where at least some financial return is usually guaranteed, even if only 10 cents in the dollar. However, liquidation rarely produces an overall favourable outcome for creditors who are likely to face extensive delays and diminished returns.

An effective corporate rescue culture requires a shift in the mental approach to the *fact* of insolvency. A corporate rescue procedure must remove (or at least minimise) the morality out of business failure.¹¹⁴ This is not to say that those persons guilty of misconduct should go unpunished, but rather that the primary focus of the parties involved in the rescue must be to maximise the valuable use of the company's assets. In the authors' view, *enforcement action should be left to regulators and liquidators*. One reason why this point is so important is that an effective rescue will almost always require the continuing assistance of incumbent management. While insolvency law (particularly personal insolvency law) has a tradition of being quasi-penal in nature, corporate rescue attempts do not provide sufficient time or resources to properly fix blame for the corporation's financial troubles.¹¹⁵

The shift in attitude from attributing blame to managing stakeholder expectations for mutual benefit is an important element in seeing the significant problems that investor class actions pose for the continuing viability of Australia's corporate rescue laws. The next section will examine a case study to draw out these tensions.

Case study: Centro Property Group

(i) Centro's financial troubles

The continuing troubles faced by the Centro Property Group provide a useful case study to examine the problems caused by investor class actions for companies attempting to reorganise using an informal workout.

The Centro group of companies is a complex web of listed and unlisted companies and trusts. Centro's main business involves managing shopping centres in Australia, New Zealand and the United States. At the end of the financial year 2006-2007, Centro had over \$26 billion in funds under management and an ASX market capitalisation of over \$7 billion.¹¹⁶ As of 8 July 2008, Centro's market capitalisation had fallen to \$38 million and has since recovered to \$306 million as of 13 November 2009.¹¹⁷ Centro's share price has gone from a high of \$10.02 on 7 May 2007 to a low of \$0.04 on 20 November 2008.¹¹⁸

Centro's business model was focused on generating fees from providing a range of services related to property management and property investment. Centro generated fees from traditional sources such as managing shopping centres and leasing retail space. However, in recent years Centro has achieved substantial growth through the development of wholesale and retail property investment funds that were indirectly listed on the ASX through stapled securities. The intricate details of Centro's business model were (and are) very complex and a full discussion is not necessary for the purposes of this article. The key points to note regarding Centro involve:

- the separation of investment from ownership of the underlying assets;
- the derivation of strong revenue streams from managing property assets (as opposed to merely owning the property assets);

¹¹³ A good recent example from the United States has been the restructuring of General Motors which has involved extensive compromises from all groups including employees, banks, bondholders and tort claimants.

¹¹⁴ Kloppers P, "Judicial Management – A Corporate Rescue Mechanism in Need of Reform?" (1999) 10 *Stellenbosch Law Review* 417 at 418.

¹¹⁵ Of course, insolvency practitioners are obliged to report potential offences under the Act to ASIC: *Corporations Act 2001* (Cth), ss 422 (receivers), 438D (voluntary administrators), 533 (liquidators).

¹¹⁶ Centro Properties Group, 2006-2007 Annual Report, p 3.

¹¹⁷ Aspect Huntley FinAnalysis.

¹¹⁸ Aspect Huntley FinAnalysis.

- locking in management rights over a long term; and
- expanding funds under management and increasing dividend distributions through continuing credit facilities.

Centro's demise came in December 2007 and gathered pace during 2008 culminating with a debt stabilisation agreement between the company and its bankers that was announced in January 2009. During this time Centro had to negotiate several time extensions with its lenders who refrained from enforcing their rights under their financing agreements. The terms of the debt stabilisation agreement are complex and need not be considered in detail here, although in summary involve:¹¹⁹

- the issue of new capital, including hybrid and stapled securities as part of a debt for equity swap with the company's bankers;
- the provision of a new debt facility to provide on going cash flow liquidity;
- a three-year extension of \$3.9 billion of Centro's debt and simplification of the group's debt structures and further extensions of debts owed by entities associated with Centro; and
- more time to sell assets to help pay down debt.

The near collapse of Centro has been driven by a number of factors. Firstly, as noted above, Centro's business model depended heavily on regularly renewing the supply of debt funding. Centro also drew substantially on funding from securitisation in the mortgaged backed security market. These two sources of funding had been both abundant and cheap for several years allowing Centro to drive its acquisitions through increasing debt levels.¹²⁰ This business model came unstuck in mid 2007 as increasing default rates in US residential mortgages called into question the valuations and risk associated with mortgaged back securities, including the increasing popular collateralised debt obligations (or CDOs). Funding through securitisation processes became more difficult as the risk and uncertainty surrounding complex debt instruments generated substantial price increases in the credit markets. The collapse of several large investment funds in the US sent a panic through credit markets and drove up credit prices for corporate debt to very high levels.¹²¹

It was during the time of tightening credit markets that Centro attempted to secure long term funding for its \$5 billion acquisition of a American-based property trust. Centro had used interim financing to secure the acquisition, and this was due to be repaid by the end of 2007. Centro therefore had to obtain longer term financing to fund the acquisition costs in the medium term. By mid-2007 credit markets around the world were tightening up and the cost of corporate debt funding had increased substantially. Although Centro made market announcements to reassure its investors that it had secured sustainable levels of borrowings, in reality it was unable to obtain long term financing at a price to meet its financial projections.

After much media speculation surrounding highly leveraged listed companies such as Allco Finance Group and MFS (now Octavio) during mid-late 2007, Centro announced on 17 December 2007 that it would need to restate its financial position. Centro had incorrectly stated that it had less than \$1.7 billion in current liabilities in its annual accounts published in August 2007. This report had characterised several billion dollars under a bridging finance facility to assist with its acquisitions as non-current liabilities which were later changed by the company to current liabilities when it was unable to secure long term financing on favourable terms to cover the bridging facility when the

¹¹⁹ Centro ASX Release, *Centro Completes Debt Stabilisation Agreement* (16 January 2009).

¹²⁰ At the end of financial year 2006-2007, Centro had total liabilities of \$4.5 billion which increased to \$14.4 billion in 2007-2008 and increased further to \$18.8 billion in 2008-2009: Aspect Huntley FinAnalysis. Although the company has also increased its assets over the same period (to \$18.2 billion in FY 2008-2009), most of its assets are non-current assets tied up with commercial property which has been in a slump for some period. Its current assets in FY2008-2009 are only \$809 million to cover \$2.3 billion in current liabilities.

¹²¹ The credit spread of "A" rated corporate bond yields over government bonds rose from 77 basis points in July 2007 to 485 basis points at the end of March 2008, and have since come down to 272 basis points on 30 September 2009: Reserve Bank of Australia, Corporate Bonds – Yields – Capital Market Yields and Spreads – Non-government Instruments-F3 <http://www.rba.gov.au/Statistics> viewed 5 December 2009.

Commercial Mortgage Backed Security Market (CMBS) effectively shut down in late 2007.¹²² Centro management claimed to be surprised by the tightening of global credit markets and had not prepared for the lack of interest in the market for issuing new mortgaged backed debt securities.¹²³

The company's 17 December announcement came after it had requested a trading halt from the ASX and resulted in the company's shares tumbling from \$5.70 to \$0.80. Subsequently, the company's share price dropped steadily to a low of \$0.04. The company's chief executive officer Andrew Scott, largely seen as the architect of Centro's aggressive expansion, resigned on 15 January 2008 and the company's share price has not risen above \$0.72 in the subsequent 23 months.¹²⁴

(ii) Centro's litigation troubles

After the decimation of the company's share price continued throughout 2008, the group has been subject to three separate investor class actions. Richard Kirby, as the representative party, commenced two actions, one brought against Centro Properties Ltd (CPL) and CPT Manager Ltd (CPT Manager) covering a period of 9 August 2007 to 15 February 2008 and another one against Centro Retail Ltd (CRL) and Centro MCS Manager Ltd (Centro MCS) relating to a period from 7 August 2007 to 15 February 2008. The Kirby proceedings were both closed class actions as the group was defined by reference to each group member having entered into a litigation funding agreement. The proceedings comprise 955 members. The solicitor on the record was Maurice Blackburn Pty Ltd and the proceedings were funded by IMF (Australia) Ltd. The third action was issued by Nicholas Vlachos, Monatex Pty Ltd and Ramon Franco, as the representative parties, and has all four Centro companies as respondents. This proceeding was a traditional opt out class action but excluded those entities in the Kirby class actions. It covers shares purchased in the period from 5 April 2007 to 28 February 2008. Slater & Gordon are the solicitors for the applicants and the proceedings were funded by Commonwealth Legal Funding LLC.¹²⁵

The quantum involved in the Kirby proceedings has been estimated by IMF to be \$150 million each and by Maurice Blackburn to exceed \$700 million, but the media has repeatedly reported that the claim could be over \$1 billion.¹²⁶ The Vlachos class action has not particularised any damages figure at this stage although the number of group members is estimated to be more than 5,000 and so damages claimed are likely to be in the hundreds of millions.¹²⁷

The complexity of the three class actions subsequently increased with CPL/CPT Manager and CRL/Centro MCS filing cross claims against their auditor PriceWaterhouseCoopers in each of the class actions. This was followed by PriceWaterhouseCoopers filing cross claims against individual Centro directors and officers.¹²⁸ Mediation attempts during 2009 were unsuccessful.¹²⁹

¹²² Centro ASX Release, *Presentation-Centro Earnings Revision Refinancing Update*, 17 December 2007.

¹²³ Centro ASX Release, n 122.

¹²⁴ Aspect Huntley FinAnalysis.

¹²⁵ See Legg M, "Entrepreneurs and Figureheads: Addressing Multiple Class Actions and Conflicts of Interest" (2009) 15(2) *UNSW Law Journal Forum* 909, 911.

¹²⁶ IMF (Australia) Ltd, *Case Investment Portfolio as at 30 June 2008*, <http://www.imf.com.au/announcements/pdf/Case%20Investment%20Portfolio%20as%20at%2030%20June%202008.pdf> viewed 30 December 2009; Dunckley M, "Centro Claims Gain Momentum", *The Australian Financial Review* (28 May 2008) p 65; Cummins C, "Centro in Court Over \$1bn Class Action", *The Age* (25 August 2008); and Dunckley M, "Bid to Separate Centro Actions", *The Australian Financial Review* (25 August 2008) p 57.

¹²⁷ Dunlevy M, "Centro Class Action Zeroes in on Insurance", *The Australian* (6 March 2009) p 19.

¹²⁸ Lenaghan N, "Alarm as Centro Moves to Sue its Auditor", *The Australian Financial Review* (27 May 2009) p 50 and Lenaghan N, "Auditor Fights Back with Counter-attack", *The Australian Financial Review* (15 July 2009) p 56.

¹²⁹ Lenaghan N, "Centro Mediation Fizzles", *The Australian Financial Review* (23 October 2009) p 54.

On 21 October 2009, ASIC commenced proceedings against current and former directors and officers of various Centro entities for failing to discharge their duties with due care and diligence in approving financial reports.¹³⁰

Centro was the darling of the ASX real estate investment trust sector (REIT) and consistently outperformed the market and the REIT sector, which led several large institutions to go overweight on Centro in their investment portfolios.¹³¹ These investors are now sitting on huge paper losses that will probably never be recovered. One method of recovering some of this lost value is to join in investor class actions. Centro has announced publicly that it will be vigorously defending the class actions.

Critique

The rapid decline of Centro, one of the world's largest property managers, provides a sober lesson regarding the tensions between investor protection and corporate rescue regimes. Centro undertook an extended informal restructuring effort in an attempt to save the business and maximise value for its stakeholders. While these efforts eventually resulted in a debt stabilisation agreement, the process was, and continues to be, fraught with the danger that lenders may refuse to allow more time to pay down debt. On several occasions during 2008 the company's lenders could have put the company into receivership and destroyed any chance of saving the business. One rescue technique that could have assisted the company in 2008 was a debt for equity swap with its bankers. A problem with proposing this was the priority position that could be given to shareholders involved in the class action lawsuits. If the banks swapped debt for ordinary equity they could be put in a subordinated position to shareholders who claimed creditor status as a result of the class actions. Thus shareholder class actions make a key restructuring device for over-leveraged companies suffering from financial distress less attractive for major creditors. There are further problems that investor class actions pose for restructuring which are discussed below. However, we should pause to consider why this is even troubling? If Centro or similarly over-leveraged companies are not valued by the capital markets why should they be saved? Furthermore, why shouldn't investors have the right to sue the company if it has misled them or otherwise failed with its market disclosure obligations?

In the authors' view the problem is that if the class actions may frustrate rescue attempts causing (in Centro's case) billions of dollars to be lost and all stakeholders being worse off than in a reorganisation. Centro faced temporary liquidity problems caused by increasing finance costs which made it difficult (though not impossible) to service its debt obligations. If Centro were able to refinance its substantial debts it should be able to continue trading. Centro has extensive asset and investment portfolios that generate strong management and investment returns and are likely to continue doing so into the future. However, these revenues are also tied to the collective nature of the portfolios operated by Centro. For example, each of its shopping centre investment portfolios has both higher quality and lower quality assets. These assets are likely to be worth more collectively to Centro than the realisable value of selling each of the shopping centres separately. This problem is exacerbated by a falling property market and high financing costs to fund further acquisitions, thereby limiting the pool of potential purchasers to companies with strong balance sheets and access to cheap finance (through top level credit ratings) or surplus cash flows, neither of which is abundant for commercial property businesses in the current climate. Furthermore, Centro is able to derive more value from managing the individual assets within the broader portfolio. Typically, the management rights are locked in for extended periods of time with the result that a purchaser of the underlying asset may not also receive the lucrative management rights. These problems of selling individual Centro assets to pay down debt are enhanced further by the market sentiment that the sales are forced sales (or "fire sales").

How then are investor class actions relevant to this situation? Investor class actions are likely to have a substantial detrimental effect on the reorganisation. One method of rescuing the business is to

¹³⁰ ASIC, *ASIC Commences Proceedings against Current and Former Officers of Centro* (Media Release 09-202AD, 21 October 2009).

¹³¹ See eg, the discussion regarding the position of UBS in Centro shares: Gottlieb B, "UBS Wants Centro to Pay", *Business Spectator* (10 June 2008), available at <http://www.businessspectator.com.au> viewed 5 December 2009.

sell it as a going concern to a larger entity that can attract more favourable rates of financing and thereby preserve enterprise asset values. However, the existence of large investor class actions makes this prospect highly unlikely as any takeover would bring with it substantial litigation risk, possibly in excess of \$1 billion. There has been speculation in the media that pending investor class actions have put off potential takeover bidders for companies under strain, including Centro and Downer EDI.¹³² Any sale of the assets that does not take into account contingent liabilities could also raise concerns about directors' duties to consider creditor interests and uncommercial transactions.

One method of reducing this litigation risk is to shift the company from an informal rescue process (which lacks a moratorium) to a formal rescue process by putting the company into voluntary administration. However, this also carries substantial difficulties as a formal appointment may trigger default clauses in valuable supply and leasing agreements (so called "ipso facto clauses") or in Centro's case terminate management contracts. This would further impair the company's ability to raise liquidity levels to trade out of its difficulties under a DOCA. These factors no doubt contributed to the choice by secured lenders to Centro to resist appointing receivers.¹³³

Of equal importance, the investor plaintiffs in the class actions could submit proofs of debt as contingent creditors, generating a great deal of complexity for the administrator in formulating a rescue plan via a DOCA and would certainly delay the whole process substantially. These difficulties may encourage secured lenders to cut their losses and appoint a receiver, effectively killing off any viable rescue plan under a DOCA. Furthermore, unsecured lenders may be tempted to sell out to distressed debt traders and recover part of their losses. This could result in further problems with negotiating a viable restructuring plan, particularly if the plan will take time to deliver valuable returns to creditors.¹³⁴

Even if the class action plaintiffs were admitted for a nominal amount (say \$1) on the basis that their claims had not been proved, their sheer number could well change the dynamics of the voting in the final creditors meeting. Aggrieved investors taking positions as contingent creditors may well outnumber other non-shareholder creditors which could influence the exercise of the administrator's casting vote as chairperson of the creditors' meeting.¹³⁵ The risk tolerance and time horizon of aggrieved investors may well be radically different from that of substantial secured and unsecured lenders causing tensions in the body of creditors and deterring long term workout strategies. While tensions between creditors are no doubt commonplace in insolvency situations, the added financial strength and will of litigation-funded investor class action plaintiffs may mean that adverse decisions by the administrator (such as rulings on proofs of debt) may be subject to more vigorous appeals,¹³⁶ again driving up the costs and increasing delays.

It is clear that the use of investor class actions casts a dark shadow over both informal and formal corporate rescue procedures. This gives rise to a legitimate question regarding what may be done to ease this tension between two valuable policy goals: investor protection and efficient corporate rescue regimes?

PT V CONCLUSION

Once it is accepted that investor class actions make an efficient and effective corporate rescue more difficult, and possibly impossible depending upon the scope of the class action, an important question

¹³² See Ferguson, n 10.

¹³³ There is also an issue where various secured lenders are structurally subordinated having lent to entities in the group that do not hold the most valuable assets.

¹³⁴ Distressed debt traders or vulture funds are renowned for seeking quick recovery on their debts rather than participating in a drawn out restructuring attempt: see further Green J, "The Impact of Credit Derivatives on Corporate Debt Restructuring" (2008) 19 JBFLP 97; Noe T and Rebello M, "Reputation and the Market for Distressed Firm Debt" (2003) 38 *Journal of Financial and Quantitative Analysis* 503; Anson M, "A Primer on Distressed Debt Investing" (2002) 5 *Journal of Private Equity* 6.

¹³⁵ A good example of this was the Sons of Gwalia administration where the thousands of shareholder/creditors influenced the exercise of the casting vote.

¹³⁶ *Corporations Act 2001* (Cth), s 1321. See generally *Selim v McGrath* (2003) 47 ACSR 537; [2003] NSWSC 927.

is raised: what is the appropriate policy response? The goals of providing investor compensation and facilitating efficient rescue procedures are equally valuable. It is almost inconceivable that law reform would need to choose between these two goals, there must be some way to achieve both goals. In the authors' view, the answer lies not in seeking to promote one goal over another, but rather to consider alternative ways to achieve the same policy outcomes but by alternative mechanisms.

The value of investor protection laws, such as prohibitions on misleading conduct and continuous disclosure laws, is undoubted. These regulatory tools help to promote transparency (and therefore confidence) in the capital markets. However, the fact that investors are given rights to compensation does not inevitably lead to the primacy of private enforcement, or indeed, private enforcement via a mass investor class action. Furthermore, achieving the goal of investor compensation does not require the use of litigation funding. There are no doubt counter-arguments addressing issues of the cost and complexity of litigation that drive the use of class actions supported by professional funders such as IMF. However, these are arguments to simplify the litigation process and reduce the cost of enforcement rather than arguments necessitating the status quo. As the Chief Justice of Western Australia has pointed out, Australia has a "Rolls Royce" civil justice system.¹³⁷ It may be preferable if issues of inadequate disclosure by major corporations are not addressed through the court system at all.¹³⁸

It may also be preferable for the corporate regulator to take a more active role in enforcing disclosure obligations. This may take the form of an increased number of *ASIC Act* s 50 proceedings rather than private class actions or perhaps the increasing use of enforceable undertakings. The Multiplex case provides a good example of ASIC obtaining a compensation fund for aggrieved investors.¹³⁹

Another option may be to establish a similar mechanism to the "fair funds for investors provision" introduced into the United States as part of the Sarbanes-Oxley reforms in 2002.¹⁴⁰ However, this would still generate litigation and the associated problems of hindering corporate rescues. It should be noted however that ASIC's regulatory enforcement activity has traditionally not sought massive damages awards so the actual impact on rescue activities might be less detrimental than private class actions.

In the authors' view, the most important policy reform would be to reconsider the scope and priority of private investor class actions. If ASIC could take a more active role in effectively enforcing securities laws and achieving compensation for investors either through litigation or enforceable undertakings, the right to bring investor class actions could justifiably be curtailed. The size of some investor class actions, the delays and uncertainties they cause, and worst still the competition between plaintiff firms, render them a sub-optimal regulatory tool. The time has come to ask "what price investor protection?" Are we prepared to sacrifice the prospects for successful corporate rescues in order to allow investors to join up with professional litigators to strike at the heart of the reorganisation by generating delays, costs and uncertainties?

In the authors' view, investors are entitled to be compensated but are not entitled to endanger the prospects of a corporate rescue in order to achieve some measure of compensation. The fact of insolvency generates a collective pool problem. The recognition of investor plaintiffs as contingent creditors by the High Court in the *Gwalia* case has let shareholders inside the tent. Restrictions on the

¹³⁷ Martin W CJ, *Bridging the Gap* (Address to the National Access to Justice and Pro Bono Conference, 20 September 2006) at [2] <http://www.supremecourt.wa.gov.au/content/news/media/speeches/2006/default.aspx> viewed 30 December 2009.

¹³⁸ For a discussion of non-judicial responses to defective disclosure see Zandstra, Harris and Hargovan n 48.

¹³⁹ See ASIC Media Release 06-443 (20 December 2006), which provides details of a \$32 million compensation fund for Multiplex investors who acquired their shares between 3 February and 23 February 2005 and were harmed by the company's defective disclosure practices. Compensation for shareholders did not prevent the commencement of class action proceedings which relate to a broader period, from 2 August 2004 to 30 May 2005. See *P Dawson Nominees Pty Ltd v Multiplex Ltd* (2007) 242 ALR 111; [2007] FCA 1061 at [9].

¹⁴⁰ For a discussion of the fair funds provision see Hargovan A and Harris J, "Sons of Gwalia and Statutory Debt Subordination: An Appraisal of the North American Experience" (2007) 20 AJCL 265.

exercise of legal rights and compromises on desired levels of financial return are part and parcel of large corporate insolvencies. Would Centro investors be so worse off if ASIC were responsible for managing the dispute with the company and seeking compensation through a negotiated settlement rather than competing class actions that may hinder the company's reorganisation and cause overall harm to all stakeholders?

In the authors' view, it is time to recognise the hidden cost of investor class actions on both formal and informal corporate rescue procedures. The status quo raises the danger that viable businesses will be unable to effectively restructure or will find it more difficult to restructure due to the threat of investor class actions. In situations involving companies trying to preserve enterprise value by restructuring during times of financial distress the tensions with the competing goals underpinning investor compensation through class actions requires attention.

POSTSCRIPT

The Minister for Corporate Law, Hon Chris Bowen, announced on 19 January 2010 that the Federal Government intends to reverse the effect of the High Court's decision in *Sons of Gwalia* due to the adverse effects of the decision, particularly uncertainty and increased insolvency and corporate finance costs. This article is primarily concerned with problems caused by investor class actions during formal and informal restructuring efforts rather than the use of formal insolvency procedures such as liquidation, however as noted above, the ability of investors to pursue their damages claims in insolvency makes formal restructuring efforts using voluntary administration and deeds of company arrangement more difficult. The government's announcement has the potential to remove this impediment to using formal restructuring mechanisms, although there are no details yet concerning how far the reversal of the *Gwalia* case will go and whether (or how) it may impact on informal restructuring efforts. It remains to be seen whether amendments to the Act will address the issues raised in this article. The devil is always in the detail and any statutory amendment may itself create further challenges and uncertainties.