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8 AUGUST 2012

Centro settlement

In May 2008 shareholders commenced a class action against the listed entities of the Centro Group – Centro Properties (**CP**) and Centro Retail (**CR**). PricewaterhouseCoopers (**PwC**), as auditors of CP and CR, were joined in 2009. The proceedings focused on the disclosure of liabilities in Centro's audited accounts for the 2007 financial year.

Shares in the Centro Group fell more than 90 per cent after Centro's then founder, Andrew Scott, revealed a failure to disclose the full extent of the Centro Group's debt. The claim against CP, CR and PwC was for losses suffered by members as a result of wrongly classifying a short-term liability as non-current (also the subject of ASIC's successful claim against Centro's directors last year).

The proceedings comprised a joint hearing of six class actions involving three separate groups of class members. Two groups were 'closed classes' represented by Maurice Blackburn and funded by IMF (Australia) Limited. The third group was an 'open class' represented by Slater & Gordon and funded by Comprehensive Legal Funding. The main issue in dispute was whether CR and CP had breached their continuous disclosure obligations and engaged in misleading and deceptive conduct by failing to properly disclose to the market the full extent of their maturing debt obligations.

PwC were joined to the proceedings because, as auditors of CR and CP, they were alleged to have made representations that were misleading or deceptive and to have knowingly been involved in Centro's alleged breach of its continuous disclosure requirements.

In the almost 25 years since courts in Australia first allowed class actions, there has been no judgment on damages in a class action brought by shareholders of a company.

The settlement

The trial commenced in the Federal Court on 5 March 2012 and was into its tenth week when the parties settled.

The defendants agreed to pay the claimants $200 million (inclusive of costs). $150 million of that sum is to be paid to the 'closed classes' of litigants, with the remaining $50 million to be paid to the 'open class' of litigants.

The settlement sum is as paid by:

- CP – $85 million;
- PwC – $67 million;

- CR – $10 million; and
- Insurers – $38 million.

The settlement sum was approved by Justice Middleton, who concluded that the amount was fair and reasonable, and in the interests of all classes of shareholders.

The settlement sum is reportedly the largest in the history of Australian shareholder class actions (against $144.5 million, agreed to in the Aristocrat proceedings. $112 million and $110 million settlement payouts were agreed to in the GIO and Multiplex proceedings, respectively).

A consequence of the settlement is that the law relating to shareholder class actions is still not settled.

Issues

Quantum

Courts have not yet had to consider the quantum of damages to award shareholders in securities class actions. There are competing public policies: to avoid windfall gains by plaintiffs on the one hand; and the need to ensure that the litigation process is manageable and reasonably efficient on the other.

The general legal principle regarding damages is that they should place the plaintiff in the position they would have been in had the wrongful conduct not occurred. This requires an examination of the circumstances of each individual shareholder in the plaintiff class and an inquiry into why each shareholder purchased its shares, what information the shareholder relied upon, each shareholder's investment strategy and the reasons why each shareholder sold its shares (if sold). However, undertaking an examination of this kind for several hundred plaintiffs is a significant and time-consuming exercise that could extinguish the intended benefits of class actions and diminish the efficiency of the judicial process.

A commonly suggested time saving method of calculating damages involves calculating the level of 'inflation' in the price of shares in the relevant company attributable to the company's failure to make full disclosure to the market. The goal of this approach is to determine the true value of the shares at the time of acquisition and the difference between that value and the amount actually paid.

Another approach (adopted in the United States) is to assume that every shareholder in such cases has suffered loss, because the price they paid was higher than it would have been had the misleading information not been published. This approach presumes that the price of a company's shares in an efficient market is an accurate reflection of all the information available to the market about the company. If this approach is adopted, companies sued by their shareholders may pay higher damages than the value of the losses caused by the wrongful conduct; ie, many shareholders could be awarded larger amounts than they would otherwise receive if the usual legal principles applied to damages.

Legal commentators consider that Australian courts are likely to adopt the United States approach. As a result, parties seem unwilling to run the risk of a judgment on damages. Shareholders are able to leverage this concern to achieve higher settlement sums.

Causation

The Centro settlement has represented a lost opportunity for courts to consider the issue of causation in shareholder class actions.

This issue was the subject of submissions in the Aristocrat, Multiplex and AWB proceedings which all settled before judgment.

The central question is whether the requirement of causation can be dealt with 'en masse' or whether it is necessary for each shareholder to establish actual reliance on the contravening conduct. Adopting the latter approach would be a time-consuming endeavour, but a consideration of causation 'en masse' is likely to result in undeserving shareholders receiving compensation.

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Public v private enforcement

Another issue for consideration is how the private class action compares to public enforcement by ASIC. ASIC successfully brought proceedings against the Centro directors seeking to have them disqualified and ordered to pay pecuniary penalties.

ASIC aimed to clarify the judicial position with respect to director responsibility over financial accounts and to deter future similar conduct. ASIC did not pursue Centro's auditors and did not seek compensation for Centro's shareholders.

In the result of ASIC's proceedings, the directors were ordered to pay modest pecuniary penalties. However the adverse repercussions were substantial.

The Centro proceedings appear to confirm that shareholder class actions are the most appropriate means for shareholders to seek compensation caused as a result of directors engaging in misleading conduct.

Apportionment of liability

The size of PwC's contribution to the settlement sum is considered by many as an indication as to their relative responsibility for the losses suffered by shareholders. The Centro settlement constitutes a warning to auditors to thoroughly review records and not to approve financial statements without appropriate levels of scrutiny.

The individual directors, joined at PwC's behest, do not appear to have paid any part of the settlement sum.

Conclusion

The Centro settlement represents a lost opportunity to develop the law of shareholder class actions.

Authored by: **Georgia Hunt**, Cornwall Stodart

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For further information please contact:

John Hutchings, Chairman of Partners
Phone (direct) **+61 3 9608 2245**
Mobile **+61 418 149 446**
Email **j.hutchings@cornwalls.com.au**