CHAPTER 12

Class Actions and Regulating Culture in Financial Organisations: Observations from a Comparison of US and Australian Bank Class Actions

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I INTRODUCTION

Class actions have a long history in the United States of being employed in relation to securities law contraventions and have been regularly employed by shareholders in Australia since at least 2005.[1] Shareholder class actions are usually advocated on the basis that they deter misconduct by allowing for the enforcement of statutory requirements for disclosure and prohibitions on misleading conduct as an adjunct to actions by regulators such as the Securities and Exchange Commission (SEC) and the Australian Securities and Investments Commission (ASIC).[2] Further, being able to commence legal proceedings allows for compensation to those who have suffered loss or damage as a result of misconduct.[3] However, both the deterrence and compensation rationales for class actions have been subject to

[1] In the United States, rule 23 of the Federal Rules of Civil Procedure have set out the requirements of the modern class action since 1966. Securities class actions have been begun in the US since the 1960s: J Tidmarsh and RTrangsrud, *Modern Complex Litigation* (Foundation Press, 2d edn 2010) 447. In Australia, class actions were introduced at the federal level through Pt IVA of the *Federal Court of Australia Act 1976* (Cth) in 1992. Similar procedures were introduced in the State of Victoria through Part 4A of the *Supreme Court Act 1986* (Vic) and in the State of New South Wales in Part 10 of the Civil Procedure Act 2005 (NSW). Australia's first shareholder class action was commenced in 1999: *King v GIO Australia Holdings Ltd* (2000) 100 FCR 209, but since 2005 the number of shareholder class actions has steadily increased. For a comparison of US and Australian class action procedure, see M Legg and L Travers, 'Necessity is the Mother of Invention: The Adoption of Third Party Litigation Funding and the Closed Class in Australian Class Actions' (2009) 38(3) *Common Law World Review* 245.

[2] *Bateman Eichler, Hill Richards Inc v Berner* 472 US 299, 310 (1985), *J I Case Co v Borack* 377 US 426, 432 (1964), *Kirby v Centro Properties Limited* [2008] FCA 1505, [8].

[3] *Deposit Guaranty Bank v Roper* 445 US 326, 339 (1980); J Cox, 'The Social Meaning of Shareholder Suits' (1999) 65 *Brooklyn Law Review* 3, 8–9.

criticism.[4] This chapter examines whether another rationale for class actions commenced by shareholders against financial organisations can be advanced, namely the regulation of culture.

Culture has many meanings depending on its context, but is considered here as a component of corporate governance. Corporate governance 'describes the framework of rules, relationships, systems and processes within and by which authority is exercised and controlled in corporations. Understood in this way, the expression "corporate governance" embraces not only the models or systems themselves but also the practices by which that exercise and control of authority is in fact effected'.[5] Corporate culture is the link between documented rules and policies and how they are actually implemented.[6] Where that culture is permissive of unethical conduct, corrupt or rises to the level of 'administrative evil', the pursuit of profit or personal gain can inflict substantial harm such as corporate scandals and collapses.[7]

In financial organisations, culture has a direct link with risk appetite and management.[8] Many banks in the lead-up to the global financial crisis developed a culture of risk-taking that saw risk management policies and practices be ignored, incorrectly applied or circumvented.[9] The risk management department was seen as an obstruction or hindrance in consummating money-making (at the time) transactions.[10] Whether a bank sees itself as an institution operating for the public good (providing deposit-taking, liquidity production, credit and security) or trying to make the greatest profit possible so as to fuel executives' incomes and competitiveness is influenced by culture.[11] However, both culture and risk can be influenced by economic incentives. A central concern arising from the global financial crisis was whether remuneration structures, including bonuses, could thwart corporate

[4] J Coffee, 'Reforming the Securities Class Action: An Essay on Deterrence and Its Implementation' (2006) 106 *Columbia Law Review* 1534, 1536–38, A Rose, 'Reforming Securities Litigation Reform: Restructuring the Relationship Between Public and Private Enforcement of Rule 10B-5' (2008) 108 *Columbia Law Review* 1301, 1312–14; M Legg, 'Shareholder Class Actions in Australia—The Perfect Storm?' (2008) 31 (3) *UNSWLJ* 669, 709.

[5] HIH Royal Commission, *The Failure of HIH Insurance, Volume 1: A Corporate Collapse and Its Lessons*, Commonwealth of Australia, April 2003 xxxiii.

[6] ibid page xvii ('By "corporate culture" I mean the charism or personality—sometimes overt but often unstated—that guides the decision-making process at all levels of an organisation.') and J Cohan, '"I Didn't Know" and "I Was Only Doing My Job": Has Corporate Governance Careened Out of Control? A Case Study of Enron's Information Myopia' (2002) 40 *Journal of Business Ethics* 275, 287–88. See also Australian Securities Exchange Corporate Governance Council, *Corporate Governance Principles and Recommendations with 2010 Amendments* (2007)13.

[7] P Zimbardo, *The Lucifer Effect: Understanding How Good People Turn Evil* (Random House 2008) ch 15 and T Leap, *Dishonest Dollars: The Dynamics of White-Collar Crime* (Ithaca, Cornell University Press 2007) 42–43.

[8] Above n5 at xvii, xxi and KPMG LLP, *The Audit Committee Journey: Charting Gains, Gaps and Oversight Priorities: 2007–2008 Public Company Audit Committee Member Survey* (2008) 6 (reporting that one of the key risks that audit committees were concerned about was 'the culture, tone and incentives underlying the risk environment').

[9] M Baily, R Litan and M Johnson, *The Origins of the Financial Crisis* (Washington, DC, Brookings Institute, November 2008) 42; UBS; *Shareholder Report on UBS's Write Downs* (Zurich, UBS, 2008) 34, D Ladipo, S Nestor and D Risser, *Board Profile, Structure and Practice in Large European Banks: A Comparative Corporate Governance Study* (London, Nestor Advisors, 2008) 45.

[10] G Kirkpatrick, *The Corporate Governance Lessons from the Financial Crisis* (Paris, OECD, 2009) 12 and 'Confessions of a Risk Manager', *The Economist*, 9 August 2008, 72–73.

governance requirements.[12] However, economic incentives can also promote corporate governance, whether provided by the organisation internally or through externally imposed enforcement sanctions.[13]

In the US, the link between changing corporate culture and enforcement has received growing recognition. The Federal Sentencing Guidelines provide that in considering whether corporations took reasonable steps to prevent and detect criminal conduct they are required to have an ethics and compliance program that must 'promote an organizational culture that encourages ethical conduct and a commitment to compliance with the law.'[14] Likewise, the Department of Justice views corporate culture as an important component of compliance programs, having commented that '[a] strong ethical culture directly supports a strong compliance program'.[15]

The significance of culture and the prospect that external sanctions can influence culture in a positive manner suggests that an examination of the relationship between class actions and culture in financial organisations may be fruitful. This chapter examines the relationship through the lens of the Bank of America Corporation class action arising from the acquisition of Merrill Lynch & Co in the United States and the National Australia Bank Limited class action arising from the increase in provisions for losses from its portfolio of collateralised debt obligations (CDOs) in Australia. The prospect of influencing culture is explored by examining the following questions: who sues? who gets sued? what are the causes of action? and what are the outcomes?

II BANK OF AMERICA CLASS ACTION

The Bank of America Corporation (Bank of America) securities class action arises from the global financial crisis in 2008 that decimated American investment banks. On 16 March 2008, JP Morgan Chase acquired Bear Stearns for US$2.00 per share, later raised to US$10.00 per share. On 15 September 2008, Lehman Bros announced it would file for bankruptcy. On 22 September 2008, Goldman Sachs and Morgan Stanley were approved by the Federal Reserve to become bank holding companies.[16]

The relevant facts[17] for the Bank of America securities class action commenced on 13 September 2008 with the CEO of Merrill Lynch & Co (Merrill), John Thain having witnessed the demise of Bear Stearns and believing that Lehman Bros would soon file for

[11] C Morris, *The Trillion Dollar Meltdown* (New York, Public Affairs, 2008) 152–55.

[12] A Blundell-Wignall, P Atkinson and S Hoon Lee, *The Current Financial Crisis: Causes and Policy Issues* (Paris, OECD, 2008) 15–16 and G Kirkpatrick, above n10, 17.

[13] See eg A Shleifer and R Vishny, 'A Survey of Corporate Governance' (1997) 52(2) *The Journal of Finance* 737, 744–45, R Thompson and H Sale, 'Securities Fraud as Corporate Governance: Reflections Upon Federalism' (2003) 56 *Vanderbilt Law Review* 859.

[14] *U.S. Sentencing Guidelines Manual* § 8B2.1(a)(2).

[15] Department of Justice, *A Resource Guide to the U.S. Foreign Corrupt Practices Act* (Washington, DC, Department of Justice, November 2012) 57.

[16] M Legg and J Harris, 'How the American Dream Became a Global Nightmare: An Analysis of the Causes of the Global Financial Crisis' (2009) 32 *UNSW Law Journal* 350, 357–58.

[17] The factual background is drawn from the judgment on the first set of strike-out motions *In re Bank of Am. Corp. Sec., Derivative & Emp. Ret. Income Sec. Act (ERISA) Litig.*, 757 F Supp 2d 260 (SDNY 2010). See also A R Sorkin, *Too Big to Fail*, (New York, Penguin Books, 2010) and W Cohan, 'The Final Days of Merrill Lynch', *The Atlantic*, September 2009.

bankruptcy, which could also render Merrill insolvent. Thain contacted the CEO of the Bank of America, Kenneth Lewis, in the hope of saving Merrill. On Sunday, 14 September 2008, Lewis agreed that Bank of America would buy Merrill for US$50 billion, which valued Merrill stock at US$29.00 per share, which was a 70 per cent premium over Merrill's US$17.00 NYSE closing price the day before. The acquisition was memorialised in a merger agreement that was signed in the early morning of Monday, 15 September 2008. One of the main negotiating points in the acquisition of Merrill was the payment of Merrill's bonus pool. Merrill wanted to pay its officers and employees US$5.8 billion in bonuses. It also wanted to pay those bonuses on an accelerated basis and prior to the transaction closing, even though the timing was contrary to its past practice. Bank of America agreed to all of these requirements. For Bank of America to be able to finance the acquisition, it conducted a secondary offering of common stock in which it sold 455 million shares at US$22.00 per share to obtain proceeds of US$9.9 billion.

In October and November 2008, Merrill incurred significant losses exceeding US$15 billion. There was discussion amongst the Bank of America's executives and board of directors as to whether the losses should be disclosed to shareholders who were required to approve the transaction or whether the material adverse condition clause in the Merger Agreement should be invoked to terminate the acquisition. The terms of the merger were set out in a Joint Proxy Statement dated 31 October 2008 (Joint Proxy) which was filed with the SEC and mailed to shareholders on 3 November 2008. In the Joint Proxy, the Bank of America directors solicited proxies to vote on the acquisition at a special meeting to be held on 5 December 2008. The Joint Proxy explained to shareholders the terms and conditions of, and the basis of the board's recommendations for, the acquisition. The Joint Proxy did not disclose Merrill's fourth quarter of 2008 losses or the bonuses that were to be paid to Merrill personnel prior to the transaction closing. On 5 December 2008, the shareholders of Bank of America and Merrill voted to approve the transaction.

Merrill continued to suffer losses, which caused Lewis to again consider exercising the right to terminate the transaction prior to closing. Lewis communicated this to Treasury Secretary Paulson. Paulson instructed Lewis to meet with him and Chairman of the Federal Reserve Board, Ben Bernanke. After further discussions among the three men, Lewis advised that the Bank of America board had determined that going through with the transaction would jeopardise Bank of America's existence as a going concern and that the transaction should be terminated. Paulson told Lewis that if the transaction was not completed, he would remove the Bank of America's directors and management from their positions. This was conveyed to the Bank of America's board of directors and it was agreed to complete the transaction.

Interestingly, Lewis feared that the consummation of the transaction could subject Bank of America to shareholder suits and he approached Federal officials to request measures to protect Bank of America from potential liability. No measures were provided. However, the Bank of America did receive a US$138 billion taxpayer bailout which consisted of a US$20 billion capital infusion and a US$118 billion guarantee against losses on certain risky assets acquired from Merrill. No written agreement was entered into because Bank of America did not wish to publicly disclose the government loans prior to the closing of the transaction.

Bank of America's acquisition of Merrill closed on 1 January 2009. On 16 January 2009, Bank of America disclosed the previous quarter's performances of both Bank of America and Merrill. It also disclosed the Federal funding. Merrill's after-tax loss for the fourth quarter of 2008 totalled US$15.31 billion, or more than US$21 billion before taxes. On 21 January 2009, news broke of Merrill's bonus arrangement. The securities class action was commenced in the Southern District of New York in relation to the non-disclosure of the bonuses to be paid to Merrill officers and employees, the fourth quarter losses sustained by Merrill and the financial assistance from the Federal government. As these facts became known, the price of Bank of America common stock plummeted from US$12.99 per share to a low of US$5.10 per share, causing a market capitalization loss of approximately US$50 billion.

III NATIONAL BANK OF AUSTRALIA (NAB) CLASS ACTION

As part of its securitisation business, nabCapital (a division of the NAB Group) purchased A $1.2 billion of CDOs through the provision of liquidity lines to conduit financing vehicles. These CDOs comprised residential mortgage-backed securities, including exposure to US subprime assets. The purchase of CDOs was part of nabCapital providing access to international debt markets for its customers. NAB's difficulties with its CDO portfolio grew out of the problems in the US subprime debt market that led to the global financial crisis.[18]

On 9 May 2008, NAB's 2008 Half-Year Results were published on the Australian Securities Exchange (ASX) website. The 2008 Results contained the following statement:[19]

> nabCapital has approximately US$1.1 billion ($1.2 billion) of CDOs in nabCapital sponsored conduits whose assets have been downgraded by rating agencies. These conduits contain exposures to US sub-prime assets of $360 million. While all assets are performing at 31 March 2008, we have established a collective provision of $181 million against the liquidity facilities extended to this asset class.

At that time, 9 May 2008, NAB told investors that the US$181 million provision was the result of 'a forensic deep dive' into the portfolio and represented 'a strong provisioning position that protects our balance sheet against whatever may come out of these in a credit sense in the future'.[20]

On 25 July 2008, NAB announced:[21]

> an additional provision of $830 million to its portfolio of 10 Collateralised Debt Obligations of Asset Backed Securities (ABS CDOs). … The amount announced today is in addition to the $181 million charge taken in the Group's half year results to 31 March 2008. The portfolio is now provisioned to a level of nearly 90%.

Consequently, with a total provision of over US$1 billion for its portfolio of CDOs, the price of NAB shares fell 13.5 per cent. Subsequently, US$880 million of the US$1 billion provision was written off.[22] As a result, a group proceeding under Pt 4A of the Supreme Court Act 1986 (Vic) alleged that NAB knew, or should have known, that it would suffer material losses on its CDO portfolio by at least as early as 1 January 2008.[23] The quantum of the claim was estimated to be A$450 million.[24]

[18] Legg & Harris, above n16, 351–354.

[19] National Australia Bank Ltd, *2008 Half Year Results* p 68.

[20] Amended Statement of Claim, 28 August 2012 para 37.

[21] National Australia Bank Ltd, *ASX Announcement–NAB Makes Provision in Response to Unprecedented Global Credit Conditions*, 25 July 2008.

[22] National Australia Bank Ltd, *2008 Annual Financial Report* p 69.

[23] *National Australia Bank Ltd v Pathway Investments Pty Ltd* [2012] VSCA 168.

[24] *Pathway Investments Pty Ltd v National Australia Bank Limited* [2012] VSC 97 at [47].

IV WHO SUES?

The entity that acts as the lead plaintiff or representative party that commences the proceedings is important because it represents the group members' interests, give instructions to the lawyers on litigation strategy and decides whether to make or accept a settlement offer. US Courts traditionally appointed the lead plaintiff and the lead counsel on a 'first come, first serve' basis.[25] This meant that the need to choose among multiple class actions was resolved in favour of whoever won the race to the courthouse. This approach created considerable concern because it produced largely lawyer-driven litigation,[26] the clients were often 'professional plaintiffs' who lacked the incentive to monitor the lawyers effectively,[27] and it gave rise to 'strike suits' (litigation commenced in the hope that a corporate defendant would settle because it was cheaper than defending the matter).[28]

The US Congress responded to the above concerns by enacting the Private Securities Litigation Reform Act of 1995 (PSLRA) that sets out mandatory procedures for the appointment of a lead plaintiff in securities class actions. The procedure, in brief, builds on the class action requirement in Rule 23 of the *Federal Rules of Civil Procedure* (FRCP) of an adequate representative party by requiring the court to consider the losses allegedly suffered by the various plaintiffs that seek to serve as the lead plaintiff and select the 'presumptively most adequate plaintiff' being the 'person or group of persons that . . . has the largest financial interest' in the suit.[29] The lead plaintiff has the responsibility, subject to the approval of the court, of selecting and retaining counsel.[30]

In short, the PSLRA addressed the concerns about lawyer control and unmeritorious litigation through the appointment of a group member with a large financial stake. As the lead plaintiff had significant funds at stake and was a sophisticated user of legal services they would, and could, actively monitor the conduct of a securities class action so as to reduce the litigation agency costs that may arise when lead counsel's interests diverged from the interests of group members.[31]

[25] E Weiss and J Beckerman, 'Let the Money Do the Monitoring: How Institutional Investors Can Reduce Agency Costs in Securities Class Actions' (1995) 104 *Yale Law Journal* 2053, 2062; *In re Cendant Corp Litig*. 264 F 3d 201, 255 (3d Cir 2001); and *In re Cavanaugh* 306 F 3d 726, 729 (9th Cir 2002).

[26] See *In re Enron Corp Securities Litigation* 206 FRD 427, 441–442 (SD Tex 2002) ('Congress was reacting to significant evidence of abusive practices and manipulation by class action lawyers of their clients in private securities lawsuits . . . . Because class counsel's fees and expenses sometimes amount to one-third or more of the recovery, class counsel frequently has a significantly greater interest in the litigation than any individual member of the class').

[27] R. C Heck, 'Conflict and Aggregation: Appointing Institutional Investors as Sole Lead Plaintiffs Under the PSLRA' (1999) 66 *University of Chicago Law Review* 1199, 1202. The indictment of law firm Milberg Weiss reveals that the 'professional plaintiffs' were often paid kickbacks in exchange for serving as lead plaintiff on class actions devised by the law firm. See J McDonald, 'Milberg's Monopoly: Restoring Honesty and Competition to the Plaintiffs' Bar' (2008) 58 *Duke Law Journal* 507.

[28] See *Blue Chip Stamps v Manor Drug Stores* 421 US 723, 740–743 (1975) and J Cooper Alexander, 'Do the Merits Matter? A Study of Settlements in Securities Class Actions' (1991) 43 *Stanford Law Review* 497, 548–50.

[29] 15 USC §78u-4(a)(3)(B)(iii)(I)(bb). The presumption can be rebutted if the proposed lead plaintiff would not fairly and adequately protect the interests of the class, or was subject to unique defences that made the plaintiff incapable of adequately representing the class. The operation of the presumption and attempts to rebut it are dealt with in *In re Cendant Corporation Litigation* 264 F3d 201 (3d Cir 2001).

[30] 15 USC §78u-4(a)(3)(B)(v). See also Federal Judicial Centre, *Manual for Complex Litigation* (4th edn 2004) 538–39.

[31] See Weiss & Beckerman, above n25

The success of the PSLRA has been demonstrated through an empirical study of securities class actions from 1996 to 2005 which found that institutional investors out perform individual investors in terms of the proceedings surviving motions to dismiss, achieving larger settlements and obtaining greater corporate governance reform.[32] However, while pension funds for public and union employees[33] have actively offered themselves as lead plaintiffs, private institutional investors[34] have stepped forward far less. The PriceWaterhouseCoopers 2011 Securities litigation study found that pension funds appeared as a lead plaintiff in twice as many cases as other institutional investors did in cases filed during 2011, and accounted for $2.7 billion, or 79 per cent, of total settlements during 2011.[35] This is reflective of a continuing trend since at least 2007 as shown by figure 1.

In the Bank of America class action the lead plaintiffs were The State Teachers Retirement System of Ohio, The Ohio Public Employees Retirement System, The Teacher Retirement System of Texas, the Netherlands pension fund, Stichting Pensioenfonds Zorg en Welzijn, represented by PGGM Vermogensbeheer B.V., and the Swedish pension fund Fjärde AP-Fonden.

In Australia there are no additional requirements for being the representative party in a shareholder class action compared to any other class action. The choice of representative

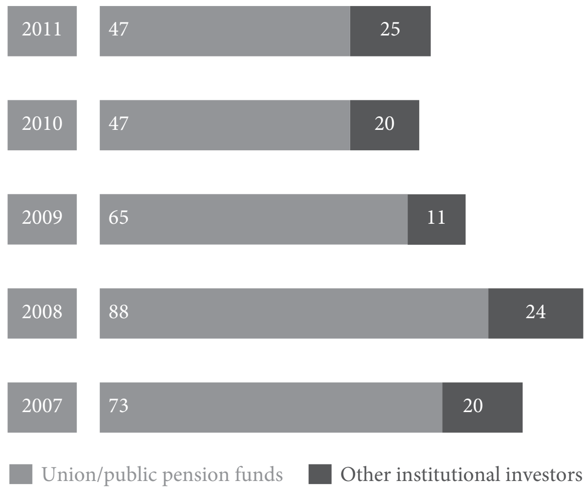

Figure 1. Number of US federal securities class action lawsuits filed with institutional investors as lead plaintiff, 2007–2011 †

†Final 2011 data is not available to date; the full year projections are based upon filings through June 30, 2011

Source: PriceWaterhouseCoopers, 2011 Securities litigation study (April 2012)

[32] A Cheng, H He Huang, Y Li and G Lobo, 'Institutional Monitoring Through Shareholder Litigation' (2010) 95 *Journal of Financial Economics* 356.

[33] For example, California Public Employees' Retirement System, the New York State Common Retirement Fund, the New York City Pension Funds, Teachers Retirement System of Oklahoma, Electrical Workers Local 357 Pension Fund, and City of Fort Myers Police Officers' Retirement System.

[34] For example, banks, mutual funds, hedge funds and insurance companies.

[35] PriceWaterhouseCoopers, *2011 Securities litigation study* (April 2012) 27–29.

party is left to the lawyers and litigation funders running the litigation, provided the requirements in the legislation are complied with.[36] While participation in shareholder class actions has not been empirically examined, anecdotal evidence suggests that industry and private superannuation funds participate, as do institutional investors and individuals.[37] However, superannuation funds and institutions have avoided being the representative party. This is likely to result from a preference for the relative anonymity that accompanies group member status, being free of litigation responsibilities such as providing discovery and because they are paying a significant percentage of any recovery to a litigation funder to devise a litigation strategy and manage the litigation process, including the lawyers.[38] This scenario was borne out in the NAB class action where Pathway Investments Pty Ltd and Doystoy Pty Ltd were the co-representative parties, both being small investors, but the group was 'wholly or mainly' institutional investors.[39]

The entity that sues, the lead plaintiff or representative party, has the capacity to influence the direction and outcome of a class action, including causes of action relied on, entities that are named as defendants and the remedy, such as the quantum accepted in a settlement. These decisions carry with them the ability to influence culture. Whether this capacity to make decisions is exercised will depend on the influence wielded by the lawyers, and in Australia, the litigation funders.

The proliferation of pension funds as lead plaintiffs in the US has been linked to their activist ideology, limited relationships with corporate management and concerns with corporate governance but also class action lawyer's contributions to public sector fund trustees and union-related political action committees to encourage the pension fund to seek to be lead plaintiff and retain the lawyers as lead counsel.[40] The latter explanation is the so-called 'pay-to-play' arrangements which have caused concern because they undermine the aims of the PSLRA by creating conflicts of interest and allowing for the lawyers to retain control of the proceedings. Even without 'pay-to-play' arrangements, it must still be recognised that the lawyers will exercise considerable influence over the proceedings due to their expertise and desire for a fee. Without in-depth consideration of the lawyer-client relationship in class actions, the pension fund as a repeat player in shareholder class actions still has significant incentives to promote its interests (and its members) as a long-term shareholder in numerous corporations, including the one that is the defendant.

Pension funds, individuals or smaller corporate investors are able to bring to bear an outsider's view on corporate culture that may align more generally with society's expectations of banks and other financial organisations. This is likely to be more risk adverse and have greater concern for shareholder or consumer interests than if another institutional investor

[36] Supreme Court Act 1986 (Vic) ss 33C and 33D which effectively require the representative party to have a 'sufficient interest' to commence a proceeding on their own behalf and that they have a claim against the defendant which is in respect of, or arises out of 'the same, similar or related circumstances' and gives rise to 'a substantial common question of law or fact' as other claimants.

[37] A Hepworth, 'Big Funds in Class Act', *The Australian Financial Review*, 28 July 2006, 1, M Dunckley, 'Bid to Separate Centro Actions', *The Australian Financial Review*, 25 August 2008 57 and A Boxsell, 'Mum and Dad Take to Class Action', *The Weekend Australian Financial Review*, 11–12 July 2009 37–39.

[38] M Legg, 'Institutional Investors and Shareholder Class Actions: The Law and Economics of Participation' (2007) 81 *Australian Law Journal* 478.

[39] *National Australia Bank Ltd v Pathway Investments Pty Ltd* [2012] VSCA 168, [7].

[40] C Silver and S Dinkin, 'Incentivizing Institutional Investors to Serve as Lead Plaintiffs in Securities Fraud Class Actions' (2008) 57 *DePaul Law Review* 471, 482–87.

such as a bank or insurance company, which may have a similar culture or at least a concern at supporting cultural change through class actions, was the lead plaintiff. The different requirements and experiences between the US and Australian class actions also raise for consideration whether the pension fund or the small corporate investor is to be preferred from the perspective of cultural change. The greater resources and longer term perspective of the pension fund suggest that it may have greater inclination to pursue corporate governance and cultural change than the small corporate investor. Further, the pension fund is more capable of exercising independent discretion from its lawyers than the small investor, should it wish to do so.

V CAUSES OF ACTION – ARE MORALITY OR ETHICS IMPLICATED?

Securities class actions are principally brought pursuant to section 10(b) of the Securities Exchange Act of 1934 (the Exchange Act), 15 U.S.C. § 78j(b) and rule 10b-5.[41] This cause of action was implicated in the Bank of America class action along with section 14(a) of the Exchange Act, 15 U.S.C. § 78n(a) and rule 14a-9 due to the issue of the Joint Proxy and sections 11, 12 and 15 of the Securities Act of 1933 (the Securities Act), 15 U.S.C. §§ 77k, 77l(a)(2), 77o due to the secondary offering.

Rule 10b-5, the implementing rule to section 10(b), states among other things that '[i]t shall be unlawful for any person, directly or indirectly. . .(b) to make any untrue statement of material fact or omit to state a material fact necessary in order to make the statements. . .not misleading'. Although section 10(b) does not provide for a private right of action, US courts have been implying a private right of action for over 30 years.[42] The elements of a section 10(b) claim are: (1) a material misrepresentation (or omission); (2) scienter; (3) a connection with the purchase or sale of a security; (4) reliance, or transaction causation; (5) economic loss; and (6) loss causation.[43] Of main concern here is the requirement for scienter. The US Supreme Court in *Ernst & Ernst v Hochfelder* (1976) 425 US 185 held that negligence was insufficient for civil liability under section 10(b); instead scienter required a showing of specific intent to defraud.[44] However, courts have also allowed deliberate or gross recklessness to suffice in certain circumstances.[45] The Second Circuit has held that 'scienter can be established by alleging facts to show either (1) that defendants had motive and opportunity to commit fraud, or (2) strong circumstantial evidence of conscious misbehavior or recklessness'.[46]

[41] W Rubenstein, A Conte, H Newberg (eds), *Newberg on Class Actions* (4th ed New York, Westlaw, 2010) §22.1 and C Harris, *Securities Class Actions: An Australia and United States Comparative Analysis* (2011) PhD Thesis, Queen Mary, University of London 55.

[42] See *Blue Chip Stamps v Manor Drug Stores* 421 US 723 (1975).

[43] *Dura Pharms, Inc v Broudo* 544 US 336, 341 (2005).

[44] *Ernst & Ernst v Hochfelder* 425 US 185, 193 n 12 (1976).

[45] *Matrixx Initiatives, Inc v Siracusano* 131 S Ct 1309, 1323–24 (2011) ('We have not decided whether recklessness suffices to fulfill the scienter requirement. Because Matrixx does not challenge the Court of Appeals' holding that the scienter requirement may be satisfied by a showing of "deliberate recklessness," we assume, without deciding, that the standard applied by the Court of Appeals is sufficient to establish scienter.' (internal citations omitted)) and William Kuehnle, 'On Scienter, Knowledge, and Recklessness Under the Federal Securities Laws' (1997) 34 *Houston Law Review* 121, 179. ('For the scienter element, most courts have concluded that recklessness is sufficient.')

[46] *ECA, Local 134 IBEW Joint Pension Trust of Chi. v. JP Morgan Chase Co*., 553 F 3d 187, 198 (2d Cir.2009).

Rule 14a-9 prohibits the solicitation of any proxy with a statement that is misleading or omits material facts. In *JI Case Co v Borak* 377 US 426 (1964), the US Supreme Court implied a private right of action and observed that '[t]he purpose of § 14(a) is to prevent management or others from obtaining authorization for corporate action by means of deceptive or inadequate disclosure in proxy solicitation'.[47] Section 14(a) may be satisfied by pleading negligence. The plaintiffs do not need to allege 'highly unreasonable' conduct, an 'extreme departure' from the ordinary of care, or 'strong evidence' of recklessness. Rather, an allegation of awareness of material deficiencies in a proxy statement is sufficient.[48]

Sections 11 and 12 create express private causes of action for material misstatements or omissions. Section 11 applies to registration statements, and § 12(a)(2) applies to prospectuses and oral communications. Specified persons may be sued—such as the issuer, directors, auditor, underwriters and lawyers. Section 15 creates liability for individuals or entities that control any person liable under §§ 11 or 12. Thus, the success of a claim under § 15 relies, in part, on a plaintiff's ability to demonstrate primary liability under §§ 11 and 12.[49]

Issuers are subject to virtually absolute liability under § 11, while the remaining potential defendants under §§ 11 and 12(a)(2) may be held liable for mere negligence. Moreover, unlike securities fraud claims pursuant to § 10(b) of the Exchange Act, plaintiffs bringing claims under §§ 11 and 12(a)(2) need not allege scienter, reliance, or loss causation.[50]

The causes of action and allegations that sufficiently pleaded the required state of mind to avoid being struck out in the Bank of America class action are set out in figure 2.

The US causes of action can be usefully contrasted with the law in Australia. The Australian causes of action invoked in shareholder class actions generally, and in relation to NAB specifically, contain no state of mind requirement. The Corporations Act 2001 (Cth) section 1041H prohibits persons from engaging in conduct in relation to a financial product or a financial service that is misleading and deceptive. The ASIC Act 2001 (Cth) section 12DA is in similar terms to section 1041H but it only relates to 'financial services'. Both are based on the consumer protection provision, section 52 of the Trade Practices Act 1974 (Cth) (now section 18 of the Australian Consumer Law which is schedule 2 to the Competition and Consumer Act 2010 (Cth)). The Corporations Act 2001 (Cth) section 1041I and ASIC Act 2001 (Cth) section 12GF(1) provide that a person who suffers loss or damage by conduct in contravention of section 1041H or section 12DA respectively, may recover the amount of loss or damage by action against the person contravening the section or against any person involved in the contravention. These provisions are based on section 82 of the Trade Practices Act 1974 (Cth) (now section 82 of the Competition and Consumer Act 2010 (Cth)).

[47] *JI Case Co v Borak* 377 US 426, 431 (1964). See also *United Paperworkers Int'l Union v Int'l Paper Co* 985 F 2d 1190, 1197–98 (2d Cir.1993). (The SEC 'promulgated Rule 14a–9 with the goal of preserving for all shareholders who are entitled to vote, not just for those who sponsor proposals, the right to make decisions based on information that is not false or misleading'.)

[48] See *Kalnit v Eichler* 264 F 3d 131, 142–44 (2d Cir 2001) and *Wilson v Great Am. Inds. Inc* 855 F 2d 987, 995 (2d Cir 1988)

[49] *Lindsay v Morgan Stanley* 592 F 3d 347, 358–59 (2d Cir 2010).

[50] *Herman & MacLean v Huddleston* 459 US 375, 382 (1983), *Lindsay v Morgan Stanley* 592 F 3d 347, 359 (2d Cir 2010).

	Section 10(b) and Rule 10b-5–scienter	Section 14(a) and Rule 14a-9–negligence	Sections 11, 12 and 15–negligence
Merrill bonuses	Yes–Bank of America, Merrill, Lewis, Thain [51]	Yes–Bank of America, Merrill, Lewis, Thain, Bank of America's directors[52]	n/a
Merrill 4th quarter losses	Yes–Lewis, Price[53]	Yes–Lewis, Price, Cotty, Thain, Bank of America's directors [54]	n/a
Federal financial support	No[55]	n/a	n/a
Secondary offering	n/a	n/a	Yes[56] Bank of America (issuer), Lewis, Price, Cotty, BofA's board of directors, Banc of America Securities LLC (underwriter) and Merrill Lynch, Pierce, Fenner & Smith Incorporated (underwriter)

Figure 2. State of mind and strike-out motions in the Bank of America class action

There is no requirement to show intent in relation to the prohibitions on misleading or deceptive conduct.[57] The provisions are drafted so as to be concerned with consequences

[51] *In re Bank of Am. Corp. Sec., Derivative & Emp. Ret. Income Sec. Act (ERISA) Litig.*, 757 F Supp 2d 260, 322–24 (SDNY 2010).

[52] *In re Bank of Am. Corp. Sec., Derivative & Emp. Ret. Income Sec. Act (ERISA) Litig.*, 757 F Supp 2d 260, 322–24 (SDNY 2010).

[53] This cause of action was initially struck out: *In re Bank of Am. Corp. Sec., Derivative & Emp. Ret. Income Sec. Act (ERISA) Litig.*, 757 F Supp 2d 260, 325–26 (SDNY 2010) but an amended complaint survived a further strike out motion: *In re Bank of Am. Corp. Sec., Derivative & Emp. Ret. Income Sec. Act (ERISA) Litig.*, 2011 WL 3211472, *5–*10 (SDNY 2010).

[54] *In re Bank of Am. Corp. Sec., Derivative & Emp. Ret. Income Sec. Act (ERISA) Litig.*, 757 F Supp 2d 260, 326 (SDNY 2010).

[55] *In re Bank of Am. Corp. Sec., Derivative & Emp. Ret. Income Sec. Act (ERISA) Litig.*, 757 F Supp 2d 260, 327–28 (SDNY 2010) and again *In re Bank of Am. Corp. Sec., Derivative & Emp. Ret. Income Sec. Act (ERISA) Litig.*, 2011 WL 3211472, *10–*11 (SDNY 2010).

[56] *In re Bank of Am. Corp. Sec., Derivative & Emp. Ret. Income Sec. Act (ERISA) Litig.*, 757 F Supp 2d 260, 332–34 (SDNY 2010).

[57] *Google Inc v Australian Competition and Consumer Commission* [2013] HCA 1, [9], [97], *Hornsby Building Information Centre Pty Ltd v Sydney Building Information Centre Ltd* (1978) 140 CLR 216, 228, 234, *Brown v Jam Factory Pty Ltd* (1981) 35 ALR 79, 86 and *ASIC v Online Investors Advantage Inc* (2006) (2005) 194 FLR 449, [138] ('Intention is irrelevant to determining whether conduct is deceptive or misleading or likely to be so.'), *ASIC v Stone Assets Management Pty Ltd* [2012] FCA 630, [33] ('Section 1041H deals with misleading or deceptive conduct. It does not require proof of a mental element.').

not the contravener's state of mind.[58] In relation to the original misleading and deceptive provision, section 52 of the Trade Practices Act 1974 (Cth), the High Court of Australia has observed that conduct not intended to mislead or deceive and which was engaged in 'honestly and reasonably' might nevertheless contravene section 52.[59]

In relation to the section 82 of the Trade Practices Act 1974 (Cth), the High Court has held that loss or damages may be recovered:[60]

> in cases in which the contravener's conduct is intentional or even directed at harming the person who suffers loss and damage. It can be engaged in cases, . . . , in which the contravener can be said to have fallen short of a standard of reasonable care as well as contravene the Act, and in cases in which there was neither want of care nor intention to harm, but still a contravention of the Act.

Chapter 6CA of the Corporations Act 2001 (Cth) gives the ASX Listing Rules legislative backing, by requiring listed disclosing entities to notify the ASX of information required to be disclosed by Listing rule 3.1 where that information is not generally available and is information that a reasonable person would expect, if it were generally available, to have a material effect on the price or value of the securities of the entity.[61] Originally a claim for damages was required to at least prove negligence.[62] Since the Financial Services Reform Act 2001 (Cth), which took effect from 11 March 2002, intent or fault has been irrelevant.[63]

The state of mind or standard of misconduct is important in achieving cultural change because it sends a message to financial organisations and the broader community of the view the law takes of the conduct. The alleged perpetrators are 'tarred' with the disapproval that accompanies labels such as fraudulent, reckless or negligent. Importantly this means that others working in the industry witness that condemnation. Fraud reflects more serious or objectionable conduct compared to negligence. Fraud has been described as 'among the most serious, costly, stigmatizing, and punitive forms of liability imposed on actors in modern corporations and financial markets'.[64] Further, '[f]raud is in the business of condemnation and punishment, not just compensation'.[65] The link between fraud and morality means that it creates a direct link to unethical behaviour which a financial organisation would wish to distance itself from or avoid.[66] There is a strong incentive to avoid being tarred as a

[58] *Hornsby Building Information Centre Pty Ltd v Sydney Building Information Centre Ltd* (1978) 140 CLR 216, 228 ('As I read section 52 (1). . .it is concerned with consequences as giving to particular conduct a particular colour. If the consequence is deception, that suffices to make the conduct deceptive').

[59] *Google Inc v Australian Competition and Consumer Commission* [2013] HCA 1, [9], *Parkdale Custom Built Furniture Pty Ltd v Puxu Pty Ltd* (1982) 149 CLR 191, 197 and *Yorke v Lucas* (1985) 158 CLR 661, 666.

[60] *I & L Securities Pty Ltd v HTW Valuers (Brisbane) Pty Ltd* (2002) 210 CLR 109, [42].

[61] Corporations Act 2001 (Cth) s 674 deals with listed disclosing entities and s 675 deals with other disclosing entities. When information is generally available is defined in s 676, and the material effect on price or value is defined in s 677.

[62] See Corporations Law s 1005, *Riley v Jubilee Mines NL* (2006) 59 ACSR 252 and *Australian Securities and Investments Commission v Chemeq Limited* (2006) 58 ACSR 169, [31].

[63] See Revised Explanatory Memorandum for the Financial Services Reform Act, [18.3] and *Australian Securities and Investments Commission v Chemeq Limited* (2006) 58 ACSR 169, [46].

[64] S Buell, 'What is Securities Fraud?' (2011) 61 *Duke Law Journal* 511, 521 and J Karpoff, D. Scott Lee and G Martin, *The Legal Penalties for Financial Misrepresentation* 8 (2 May 2007) (unpublished manuscript), available at http://ssrn.com/abstract=933333.

[65] Buell, ibid.

[66] J Park, 'Rules, Principles and the Competition to Enforce Securities Laws' (2012)100 *California Law Review* 115, 169. ('Prohibitions against fraud, breaches of duty by fiduciaries, and theft are not just part of securities regulation but reflect common social norms that are reflected in the common law.').

fraudster. The rule 10b-5 requirement of scienter has been criticised because something less than clear fraudulent behaviour, namely recklessness, is sufficient for a contravention thus diluting the moral turpitude associated with a particular activity.[67] Nonetheless, if a specified state of mind or standard of behaviour such as recklessness or negligence is required then the perpetrators cannot be heard to say that it was an innocent mistake or inadvertence. Their actions still deserve blame and financial organisations receive direction as to the conduct they should prevent.

The focus in Australia is consumer protection and fostering an informed market—utilitarian rather than moralising.[68] While rule 10b-5 may be criticised for being a 'legal Swiss army knife' that has multiple purposes including shaming, regulating and compensating so that one is uncertain as to the character of the underlying conduct,[69] the Australian misleading conduct prohibitions and continuous disclosure provisions are limited to the latter two objectives so there is never any occasion to allege, let alone prove conduct that has the colour of fraud. The Australian provisions lack the degree of culpability that is found in the US provisions and consequently do not seek to demonstrate moral turpitude. The lack of a fault element means that the stigma which can be associated with a successful claim, or even allegation, is significantly lower, if non-existent compared to the US causes of action. It is therefore suggested that the US causes of action have a greater ability to promote cultural change than the Australian provisions. But this is likely to be mediated by how class action suits are perceived by financial organisations and the public, as well as whether claims are actually proven or simply result in settlements. These factors are explored further below.

VI WHO GETS SUED?

A further issue in examining whether shareholder class actions are effective at achieving cultural change is whether such change is best transmitted through suits that are brought against the financial organisation and/or against individuals, such as directors and officers of that organisation.

In the United States, shareholder class actions are brought against the company but also frequently name a number of individuals such as the Chief Executive Officer and directors. In Bank of America the claims that survived strike out motions resulted in the following entities and individuals being sued:

- Bank of America
- Kenneth Lewis (Bank of America CEO, President and Chairman)
- Joe Price (Bank of America CFO)
- Neil Cotty (Bank of America Chief Accounting Officer)
- Fifteen Bank of America directors
- Merrill
- Thain (Merrill CEO and Chairman)
- Banc of America and MLPFS (underwriters)

[67] Buell, above n64, 552.

[68] *Sons of Gwalia v Margaretic* (2007) 231 CLR 160; [2007] HCA 1, [18], [122]; *Jubilee Mines NL v Riley* (2009) 226 FLR 201; [2009] WASCA 62, [87]; *National Australia Bank Ltd v Pathway Investments Pty Ltd* [2012] VSCA 168, [61].

[69] Buell, n.64 above, 540–541.

Not all persons or entities were the subject of each cause of action. Figure 2 shows which causes of action were brought against each person or entity. The prevalence of claims against individuals, more generally, is demonstrated by figure 3 which shows the percentage of class actions that named particular officers between 2007 and 2011.

It should also be noted that in the US there is no aiding and abetting liability in relation to the main provision relied on for private securities actions, Rule 10b-5.[70] Consequently individuals must personally contravene rule 10b-5 rather than assist the corporation in a contravention.

In Australia, shareholder class actions are usually brought against the corporation only, as was the case in relation to NAB. This is the case even though the provisions imposing liability for a breach of the continuous disclosure regime or misleading conduct do allow for claims of aiding and abetting, otherwise known as accessorial liability.[71] Individuals such as directors are usually only joined to proceedings when the corporation lacks the financial resources to pay a judgment or settlement and the plaintiff wants to be able to access the director's insurance policy.[72] The other exception has been where directors are the subject of a cross-claim by either the corporation or another defendant, such as an adviser.[73]

From a cultural change perspective, one school of thought is that directors and officers need to be held responsible because it is those individuals who create and give effect to culture. Ethical behaviour by directors can promote ethical behaviour by the organisation.[74] This approach is exemplified by the 'tone at the top' approach to corporate governance which has been adopted by a number of influential US corporate governance codes or recommendations, including Business Roundtable (an association of CEOs of leading US corporations), The Conference Board Commission on Public Trust and Private Enterprise and Teachers Insurance and Annuity Association–College Retirement Equities Fund

Title	2007	2008	2009	2010	2011
CEO	90%	74%	79%	86%	86%
CFO	79%	65%	61%	63%	69%
Chairman	66%	50%	46%	66%	59%
President	56%	53%	62%	71%	57%
Director	51%	35%	42%	58%	64%

Figure 3. Percentage of US federal securities class action lawsuits naming particular officers, 2007–2011

Titles are based on those named in the complaint

Source: PriceWaterhouseCoopers, 2011 Securities Litigation Study (April 2012)

[70] *Central Bank of Denver NA v First Interstate Bank of Denver NA* 511 US 164, 177 (1994); *Stoneridge Inv. Partners, LLC v Scientific-Atlanta, Inc* 552 US 148, 158 (2008).

[71] Corporations Act 2001 (Cth) ss 79, 674(2A), 675(2A), 1041I and *ASIC Act 2001* (Cth) s 12GF(1).

[72] See eg, *Guglielmin v Trescowthick (No 2)* (2005) 220 ALR 515; Matthew Drummond,'Scarfe Action Settled' *The Australian Financial Review*, 13 October 2006 16.

[73] N Lenaghan, 'Alarm as Centro Moves to Sue Its Auditor', *The Australian Financial Review*, 27 May 2009 50; N Lenaghan, 'Auditor Fights Back with Counter-Attack', *The Australian Financial Review*, 15 July 2009 56.

[74] J J du Plessis, A Hargovan and M Bagaric, *Principles of Contemporary Corporate Governance* 2nd edn (Cambridge, Cambridge University Press, 2011) 125.

(a private pension fund that is the largest US pension fund, public or private).[75] Moreover the National Association of Corporate Directors' *Key Agreed Principles to Strengthen Corporate Governance for U.S. Publicly Traded Companies* specifically provides that 'it is the board that is charged with … setting the "tone at the top"'.[76] Further, in the context of enforcement the DOJ has observed that 'Within a business organization, compliance begins with the board of directors and senior executives setting the proper tone for the rest of the company'.[77] If directors and officers are responsible for corporate culture, then holding them accountable for failures of that culture is a sensible approach.

However, the effectiveness of claims against directors and officers must take account of two factors. First, if those individuals are insured and the claims settle so that no wrongdoing is found, then it is not the individuals who pay but an insurer. In the US, the insurance policy covers directors provided they act in good faith and in the best interests of the corporation. Settlement prevents any findings that would show a director to have acted contrary to these requirements.[78] Similar requirements exist in Australia.[79] Second, a settlement may be paid in full by the organisation so that the individuals, once again, do not pay. In the US, the corporate entity may favour settlement so as to not compromise its insurance which may exclude claims based on fraud, which can be an element of US causes of action.[80] In the Bank of America class action settlement, the organisation paid the entire settlement with no contribution from any individual.[81] In Australia, the fear of fraudulent conduct does not arise due to the nature of the contraventions. While personal liability may be seen as a way in which to encourage a positive corporate culture, the incentives in insurance may undermine personal liability as a practical solution.

Another approach is to see culture as something greater than any particular individual. Corporate culture is more than the sum of its directors and officers; it has historical, economic and sociological aspects. The corporation as a separate legal entity may be conceived of as also having a separate culture or ethos from the individuals who compose it. The financial organisation may be conceived of as a 'group' that through situational forces causes individuals to act differently compared to when they are alone.[82] If it is organisational cultural change that is sought, then it is the organisation that must be found to have contravened the law.[83] A focus on individuals allows the organisation to avoid responsibility

[75] Weil, Gotshal & Manges LLP, *Comparison of Corporate Governance Guidelines and Codes of Best Practice: United States* (December 2012) 5, 7, 58.

[76] National Association of Corporate Directors, *Key Agreed Principles to Strengthen Corporate Governance for U.S. Publicly Traded Companies* (2008) 5.

[77] Department of Justice, *A Resource Guide to the U.S. Foreign Corrupt Practices Act* (November 2012) 57.

[78] M Klausner, 'Personal Liability of Officers in US Securities Class Actions' (2009) 9(2) *Journal of Corporate Law Studies* 349, 355.

[79] P Mann, 'Directors' & Officers' Insurance in the Regulatory Litigation Context' in M Legg (ed), *Regulation, Litigation and Enforcement* (Sydney, Thomson Reuters, 2011) 73–74, 76.

[80] Klausner, above n78.

[81] A Frankel, 'How BofA Was Forced to Settle $2.43bln Merrill Class Action' *Thomson Reuters News & Insight*, 28 September 2012.

[82] See eg, N K Katyal, 'Conspiracy Theory' (2003) 112 *Yale Law Journal* 1307, 1316–24, 1355–58 and Zimbardo, above n7, ch 12.

[83] See Memorandum from Larry Thompson, Deputy Attorney General, US Department of Justice, to Heads of Department Components, US Department of Justice (Washington DC, Department of Justice 20 January 2003) ('Indicting corporations for wrongdoing enables the government to address and be a force for positive change of corporate culture, alter corporate behavior, and prevent, discover, and punish white collar crime.').

and point at the 'bad apple,' the individual who is responsible. To put the argument another way, contraventions of the law that arise because of the organisational culture rather than the misdeeds of certain individuals require the organisation to be held to account.[84]

The organisational or enterprise liability approach has been subject to criticism in terms of both deterrence and compensation in the area of securities law because payments by the institution for wrongdoing, whether fines or damages, are effectively payments made with shareholder funds and that punishes the shareholders, rather than management which is responsible for the contravention.[85] Further, it is the directors, not the shareholders, who determine how to deter misconduct within the organisation, yet they may be the ones engaged in misconduct.[86] The debate as to whether organisational liability or individual liability is more effective in achieving compensation or deterrence is likely to continue. The addition of a new objective in terms of cultural change provides a further perspective on that debate.

VII OUTCOMES

In the United States, a trial by jury is a constitutional right in common law suits where the value in controversy exceeds $20.[87] The jury was 'an important element in the emergence of democratic-egalitarian values in Anglo-American society' due to its 'populist, lay quality'.[88] Moreover, juries allow for social judgments as to what is fair and equitable.[89] The jury as the ultimate finder of fact and in rendering the verdict can provide societies with input on what is acceptable conduct in financial organisations. A class action with trial by jury could allow for society to pass judgment on Bank of America's conduct. The Australian legal system places far less reliance on jury trials than the United States, but they are available, subject to the court's discretion, for class actions in Victoria.[90] However, the merits of the jury trial, or a reasoned and public judicial determination, do not require further assessment as almost all class actions settle.

The prospect of a public trial with evidence in which financial organisations are called to account is very remote. In the US, from the passage of the PSLRA in late 1995 until the end of 2011, there had been only 29 securities class action trials, as compared to a total of over 3,800 filings. Of those 29 trials, 6 settled prior to a verdict being reached.[91] In Australia, no

[84] See S Buell, "The Blaming Function of Entity Criminal Liability" (2006) 81 *Indiana Law Journal* 473 (examining the rationale for criminal institutional liability).

[85] J Arlen and W Carney, 'Vicarious Liability for Fraud on Securities Markets: Theory and Evidence' (1992) *University of Illinois Law Review* 691, 719; J Coffee, 'Reforming the Securities Class Action: An Essay on Deterrence and Its Implementation' (2006) 106 *Columbia Law Review* 1534, 1556–57; *SEC v Bank of America Corp* 653 F Supp 2d 507, 509 (SDNY 2009) (finding a consent judgment involving the corporate entity paying a fine of US$33 million as unfair as 'it does not comport with the most elementary notions of justice and morality, in that it proposes that the shareholders who were the victims of the Bank's alleged misconduct now pay the penalty for that misconduct') and *SEC v Bank of America Corp* 2010 US Dist Lexis 15460, *15–16 (SDNY Feb 22 2010).

[86] Arlen and Carney, *ibid*, 711–712. The derivative suit provides an avenue whereby shareholders may pursue corporate claims against directors for misconduct.

[87] US Constitution, Seventh Amendment.

[88] J Friedenthal, M K Kane and A Miller, *Civil Procedure* 4th edn (New York, Westlaw, 2005) 508–509.

[89] ibid, 510.

[90] *Matthews v SPI Electricity Pty Ltd (Ruling No 8)* [2012] VSC 318 (motion for jury trial by representative party in class action arising from bush fire denied).

[91] J Milev, R Patton, S Starykh, and J Montgomery, *Recent Trends in Securities Class Action Litigation: 2011 Year-End Review* (New York, NERA Economic Consulting, 14 December 2011) 12–14.

shareholder class action, whether against financial organisations or other listed corporations, have resulted in a judgment. The Centro, Australian Wheat Board, GPT Group and Aristocrat shareholder class actions went to trial but settled at various points prior to judgment.[92]

Neither the Bank of America or NAB class actions went to trial. Bank of America agreed to pay US$2.43 billion and continue a series of corporate governance measures that the SEC had obtained through its enforcement action. The lawyers were awarded legal fees of US$153 million and litigation expenses of US$8 million.[93] NAB has agreed to pay A$115 million in settlement of the proceedings, including interest and legal costs of A$11.8 million.[94]

Settlement rather than trial can reduce the force of a class action in communicating what is acceptable conduct because no violation is found.[95] However, settlement does not completely deprive the community of an examination of the alleged illegal conduct as in both the US and Australia the settlement of a class action requires court approval.[96] In the US, the court may approve a settlement only after a hearing and on finding that it is 'fair, reasonable, and adequate'.[97] The Federal and Victorian Courts in Australia have adopted practice notes that specify:[98]

> When applying for Court approval of a settlement, the parties will usually need to persuade the Court that: (a) the proposed settlement is fair and reasonable having regard to the claims made on behalf of the group members who will be bound by the settlement; and (b) the proposed settlement has been undertaken in the interests of group members, as well as those of the Plaintiff, and not just in the interests of the Plaintiff and the Defendant/s.

Court approval of the settlement usually requires evidence from the parties as to why the settlement should be approved which includes opinions on prospects of success, allows for group members to object to the settlement, provides an opportunity for the media to bring the settlement to the public's attention and results in a judgment setting out the key terms of the settlement, such as the amount paid. [99]

[92] Multi-party financial product proceedings brought by 'customers' against banks have displayed a different trend with two proceedings, one involving synthetic collateralised debt obligations (SCDOs) against Lehman Bros Australia Ltd and another constant proportion debt obligations (CPDOs) against Local Government Financial Services Pty Limited, ABN AMRO Bank NV and Standard & Poor's, all being tried and judgments being delivered: *Wingecarribee Shire Council v Lehman Brothers Australia Ltd (in liq)* [2012] FCA 1028 and *Bathurst Regional Council v Local Government Financial Services Pty Ltd (No 5)* [2012] FCA 1200.

[93] *In re Bank of Am. Corp. Sec., Derivative & Emp. Ret. Income Sec. Act (ERISA) Litig.*, Order Awarding Attorneys' Fees and Expenses (SDNY Castel J, 8 April 2013) [4], [10].

[94] *Pathway Investments Pty Ltd v National Australia Bank Ltd* [2012] VSC 625, [13], [15].

[95] R Frankel, "The Disappearing Opt-Out Right in Punitive-Damages Class Actions" (2011) *Wisconsin Law Review* 563, 608. ("A settlement is little more than a truce between the parties, that is, an agreement to resolve a dispute rather than any statement about the defendant's wrongdoing.").

[96] *Federal Rules of Civil Procedure* (US) r 23(e), *Federal Court of Australia Act 1976* (Cth) s 33V and *Supreme Court Act 1986* (Vic) s 33V.

[97] *Federal Rules of Civil Procedure* (US) r 23(e)(2).

[98] Federal Court of Australia, Practice Note CM17, *Representative Proceedings Commenced under Part IVA of the Federal Court of Australia Act 1976*, 1 August 2011 at [11.1] and Supreme Court of Victoria, Practice Note No 9 of 2010, *Conduct of Group Proceedings*, 29 November 2010 at [11.1].

[99] M Legg, 'Role of the Judge in the Settlement of Representative Proceedings: Lessons from the United States' Class Action Experience' (2004) 78 *Australian Law Journal* 58.

[100] Park above n66, 160.

The amount of a settlement can send a signal about the nature of the violation. A significant settlement can indicate that there is merit to an allegation and the law has been violated.[100] The Bank of America settlement of US$2.43 billion is the eighth largest securities class action lawsuit settlement in US history and the fourth largest settlement funded by a single defendant for violations of the federal securities laws.[101] The NAB settlement makes it the third largest shareholder class action settlement in Australian history, behind the Centro settlement of A$200 million (although PriceWaterhouseCoopers contributed an estimated A$67 million) and the Aristocrat Leisure settlement of A$144.5m and just ahead of the Multiplex settlement of A$110 million.

Both class actions result in large monetary settlements relative to other class action settlements for similar causes of action. However, the meaning of those amounts in terms of wrongdoing must factor in that losses as a result of Bank of America's and NAB's alleged misconduct was estimated to be US$50 billion and A$450 million, respectively. When the settlements are looked at from the perspective of a percentage of losses, Bank of America's settlement is 4.8 per cent of the losses (excluding legal fees) and NAB's settlement is 23 per cent of losses (excluding legal fees).

Further, like most securities class action settlements, the Bank of America settlement does not come with any admission of liability; indeed, the bank asserted in a statement that it was done 'to eliminate the uncertainties, burden and expense of further protracted litigation.'[102] Similarly, the NAB's announcement to the ASX stated that 'The settlement has been reached on a commercial basis and there is no admission of liability by NAB'.[103] Yet, in contrast, the plaintiff's lawyer in the NAB proceedings told reporters: [104]

> It's the biggest company in Australian history to pay a class action settlement of this size: over $100 million…In that sense, we think it sends a message to all Australian companies, no matter how big they are, that they do have an obligation to keep their shareholders informed of important material information, and that shareholders are willing and able to seek compensation where something goes wrong.

There is a clear contrast between the defendant's position of settlement being a cost-benefit analysis and the plaintiff's view that large payments send a message to organisations about the need to comply with legal requirements. The effectiveness of financial payouts, especially when the size of the settlement is compared to the losses caused, is questionable. A US$2 billion payment is serious money but does that headline figure assist in changing culture when the losses caused are many multiples of that amount? More generally, it has been reported that in the US the median ratio of settlements to investor losses has declined from 7 percent in 1996 to 1.8 percent in 2012.[105]

[101] The ten largest securities class action settlements are recorded on the Stanford Securities Class Action Clearinghouse website: http://securities.stanford.edu/top_ten_list.html The three largest single-defendant securities class action settlements are Tyco's $2.975 billion settlement in 2007; Cendant's 1998 settlement ($2.83 billion); and Citigroup's $2.65 billion contribution to the WorldCom case settlement. The total amount paid in settlement in each of these cases was larger than these amounts due to the contributions of other defendants.

[102] P Henning and S Davidoff, 'For Bank of America, More Trouble From Merrill Lynch Merger', *The New York Times – DealBook*, 28 September 2012.

[103] National Australia Bank, ASX Announcement – Class action Settlement, 9 November 2012.

[104] 'NAB Class Action Settled for $115million', 9 News Finance, 9 November 2012 available at http://finance.ninemsn.com.au/newsbusiness/aap/8561824/nab-settles-class-action-for-85m.

[105] R Comolli, S Klein, R Miller and S Starykh, *Recent Trends in Securities Class Action Litigation: 2012 Full-Year Review* (New York, NERA Economic Consulting, 29 January 2013) 33.

The combination of low percentage recoveries, lucrative fees for lawyers and the view that it is one set of shareholders compensating another has resulted in US class actions being referred to as 'legalized blackmail', 'litigation monsters' and 'litigation that enriches lawyers without providing any real benefit to society'.[106] The US Chamber of Commerce has stated that 'securities class actions are costly and burdensome, do not serve the goals of compensating injured investors or deterring wrongful conduct, and enrich lawyers at the expense of the average shareholder'.[107] The prospect of cultural change driven by either a desire to avoid monetary payments or adverse reputational effects is limited if class actions lack legitimacy.

However, before dismissing settlement payments as too low, it is necessary to consider the alternative—regulator action.[108] In both of the class actions under study, the actions of regulators were implicated. Bank of America had previously paid a US$150 million penalty in 2010 in a case filed by the SEC over the proxy disclosure.[109] In relation to NAB, there have been no reported fines or penalties but the Australian Prudential Regulation Authority (APRA) had been communicating with NAB over its portfolio of CDOs during the relevant period. The plaintiffs sought to subpoena documents from APRA relating to meetings between it and NAB but the subpoena was set aside as the court found that section 56 of the Australian Prudential Regulation Authority Act 1998 (Cth) prevented disclosure.[110] There was also no public action taken by the securities regulator, ASIC. Without the class action shareholders in NAB would most likely have recovered no compensation. From a regulatory approach perspective a regulator may choose not to impose fines or pursue litigation because the circumstances may be such that compliance can be better achieved through cooperation.[111] However an effective compliance outcome for the regulator may be cold comfort for an out-of-pocket shareholder.

Class actions can also include corporate governance reforms as part of a settlement, although this is rare in the US and unheard of in Australia. The settlement agreement with Bank of America requires that the bank will institute and/or continue certain corporate governance enhancements until January 1, 2015, including those relating to majority voting in director elections, annual disclosure of noncompliance with stock ownership guidelines, policies for a board committee regarding future acquisitions, the independence of the board's compensation committee and its compensation consultants, and conducting

[106] A Bloom, 'From Justice to Global Peace: A (Brief) Genealogy of the Class Action Crisis' (2006) 39 *Loyola of Los Angeles Law Review* 719, 720; N Scott, 'Don't Forget Me! The Client in a Class Action Lawsuit' (2002) 15 *Georgetown Journal of Legal Ethics* 561.

[107] US Chamber of Commerce's Institute for Legal Reform, *Securities Class Action Litigation: The Problem, Its Impact, and the Path To Reform* (July 2008) 1.

[108] Another alternative would be individual suits but the lack of economies of scale and collective action problems make this less likely.

[109] See *SEC v Bank of America Corp* 2010 US Dist Lexis 15460 (SDNY Feb 22 2010). An earlier settlement of US$33 million had been rejected. See *SEC v. Bank of America Corporation* 653 F Supp 2d 507 (SDNY 2009).

[110] *Pathway Investments Pty Ltd v National Australia Bank Ltd* [2012] VSC 429.

[111] This approach is consistent with the influential responsive regulation and enforcement pyramid approach set out in I Ayres and J Braithwaite, *Responsive Regulation* (Oxford, Oxford University Press 1992). However J Braithwaite, *Regulatory Capitalism* (Cheltenham, Edward Elgar 2008) 76 has suggested that private enforcement should be included in a tri-partite responsive regulation.

[112] Bank of America, Media Release - Bank of America Reaches Settlement in Merrill Lynch Acquisition-Related Class Action Litigation, 28 September 2012.

an annual'say-on-pay' vote by shareholders.[112] Corporate governance reforms whereby the corporation agrees to improve its governance in specific areas and to retain, at its own expense, an independent third-party to oversee and report on the corporation's implementation of that program can achieve more far-reaching and longstanding cultural change than the payment of compensation.[113] These types of reforms have usually been the province of regulatory agencies or derivative suits, but if used more frequently in class actions, they could reverse the lack of legitimacy referred to above. This is because they address governance directly for the benefit of continuing shareholders and without any gain to lawyers or litigation funders. Further, governance reforms can be specific and intrusive as shown by Bank of America's refusal to accept some of the suggested changes put forward by Judge Rakoff in relation to the proposed consent judgment agreed with the SEC.[114] If a defendant agrees to specific governance reforms as part of a settlement, then this may signal that past policies were problematic and that change is needed. Further, settlement negotiations over governance reforms require the parties to consider the scope of the reform and what it will achieve. This process may facilitate cultural change through the representative party articulating existing shortcomings and the defendant either agreeing or defending the current position. However, governance reforms are not a panacea as they could be window dressing rather than real reform, but in a class action that must receive court approval the prospect of a judge, like Judge Rakoff, giving the reforms close attention would provide some protection.

VIII CONCLUSION

This chapter has sought to examine whether class actions can be used to regulate culture in financial organisations. To address that topic the following questions were posed and considered: Who sues? Who gets sued? What are the causes of action and what are the outcomes? The analysis suggests that corporate culture may be influenced indirectly through class actions creating an incentive for the organisation to takes steps to prevent future contraventions and the associated reputational harm and need to pay compensation. In many ways the analysis of class actions promoting deterrence applies to class actions and cultural change. This includes a number of factors which both hamper deterrence and the likelihood of class actions being successful in achieving cultural change. In particular, the combination of most class actions settling, the settlement amount being a small percentage of actual losses and the corporate view that class actions lack legitimacy may undermine the prospects of cultural change. All three of these factors were present in Bank of America and NAB, with both defendants settling without any admission of liability and citing the settlement as being entered into to minimise corporate costs. It is difficult to see how a class action can be a harbinger of change when its meaning is so readily contestable. In the Australian context, the class action is further undermined by the lack of a moral or fault element in the substantive causes of action.

[113] D Hess and C Ford, 'Corporate Corruption and Reform Undertakings: A New Approach to an Old Problem' (2008) 41 *Cornell International Law Journal* 307.

[114] *SEC v Bank of America Corp* 2010 US Dist Lexis 15460, *14–15 (SDNY Feb 22 2010) (suggesting that a compensation consultant be chosen jointly by the bank, the SEC and the Court).

However, this gloomy portrait must be balanced against a number of positives. The class action, especially with a pension fund but also an individual investor as the representative party, offers an external monitor of corporate conduct that has a different culture to the defendant corporation and may be more in tune with broader social expectations of financial organisations. The class action can also draw attention to alleged corporate misbehaviour that regulators either do not take action on, in the case of NAB, or resolve for small sums of money, as was the case with Bank of America. Subject to the limitations discussed above, the class action can impact reputations and the bottom line. Class actions can also include corporate governance changes that may promote cultural change through altering and monitoring corporate policies. The inclusion of corporate governance reforms may also respond to the arguments that class actions lack legitimacy. The role and effectiveness of class actions in the US and Australia are highly contested. As a result, the ability of the class action to regulate culture is not clear cut with both opportunities and hindrances to achieving culture change within financial organisations.