WHY THE WORLEY COURT ACTION IS A LANDMARK CASE FOR BOARDS

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Legal Briefings – By **Shelley Dempsey, Australian Institute of Directors**

A recent landmark court decision on class actions is being interpreted as a signal to boards and directors that they may successfully defend class actions if they can show they took reasonable steps to determine how decisions were made. Herbert Smith Freehills partner Jason Betts, who will host an AICD webinar in January on the issue, analyses what the recent Federal Court dismissal of the class action against listed company Worley means for directors and boards.

In October, the Federal Court dismissed class action proceedings against listed engineering services firm Worley. The firm's successful defence of the $50 million securities class action in the Federal Court is only the second such case to proceed to judgment. Law firm Herbert Smith Freehills – which represented Worley – said the decision to dismiss the proceedings was a significant outcome for Worley. Partner Jason Betts called it an "important day" in Australia's class actions history and said the court's decision represents the first dismissal of allegations of a continuous disclosure breach after a full trial.

While Shine Lawyers has mounted an appeal, Betts predicts that Australia's class action landscape may nevertheless shift following the Federal Court decision. In a recent question-answer interview with the AICD, he breaks down why the recent case is important and what it means for directors and boards.

The Worley class action was recently dismissed by the Federal Court in Australia. Why is this being seen as a landmark result?

The primary reason it is seen as an important decision is because there are so few shareholder class actions that have gone through to a judgment of the court on merits. So, firstly, it's a rare commodity just by virtue of the fact that judgment was delivered. The second reason is that we haven't had the opportunity for courts to examine how they see the continuous disclosure obligation working in practice. And so this is a relatively rare occasion to consider how the court determines a challenge to a company's earnings guidance, and whether that guidance had a reasonable foundation, because that's such an important part of how listed entities face the market. It's an important decision in the context of continuous disclosure of risk, and by analogy corporate governance and regulatory risk. These are among the top risks faced by listed Australian entities in the compliance space.

What are the implications here for directors and for boards?

The judgement demonstrates how, through a documentary paper trail, a listed entity might seek to demonstrate the reasonable basis for its guidance. And importantly, the relevant question is not whether the guidance was right or wrong, the relevant question is "when given, was the guidance reasonable?".

And so I think it reinforces a couple of points. One is that financial guidance, like an earnings prediction or another financial forecast, is an opinion of the listed entity, and ultimately an opinion of the board of the listed entity, which is intuitive, because you're guiding the market to future prospects, and you would expect the board to consider and embrace that before it's released.

The second is that the judgment might be regarded as an example of what it means for a listed entity to prove that it had a reasonable basis for what it said to the market. In the Worley decision, some focus was placed on the budget underlying the guidance, and whether the budget process was reasonable, and if so, was that reasonable process demonstrated on the documents and through witnesses in a way that gave the guidance as a proper foundation? So it's an important insight into how to manage a careful process that supports a defence to a subsequent challenge to a guidance.

What are the possible implications here for D&O insurance cover?

The market has been under enormous pressure. We're seeing premium increases that are enormous – 300 per cent or more. In some cases there is an inability to obtain any coverage at all. That feels unsustainable. So if there are a series of court decisions that ultimately recalibrate class action risk, and that demonstrate that viable defences can succeed in court, or that can prevent a regulatory investigation, we may see in the longer term some recovery in that part of the insurance market. But given the state of distress it's in, that may not be a short-term proposition.

At the AICD, we've provided guidance on minutes. So do minutes come into play here?

The AICD and the Governance Institute of Australia's guidance around minutes (available here), particularly post Royal Commission, has been really important, because a lot of these lessons were also principles that were discussed at the Royal Commission, but often through a strained lens.

The Worley case highlights that it is important to keep a very clear documentary record on how decisions and opinions are arrived at. That doesn't mean a transcript of every conversation that ever occurred. Particularly at board level, that's not the function of minutes, but it does mean there needs to be a clear footprint within the minutes of what factors were taken into account, that shows that the board engaged meaningfully with those factors. Those are the pillars of reasonableness and an element of good corporate governance.

Does the court decision give any hope to directors they can successfully fight class actions?

Broadly, over the last decade we have seen a combination of the growth of the class action funding market in Australia and the increase in the frequency of shareholder class actions, plus the contraction of the insurance market. And a concern within corporate Australia that this class action momentum isn't sustainable and might lead to more listed entities saying: 'I have a viable defence and I propose to run it', assuming they have the support of any responsive insurance, and then assuming they feel they can prove that defence and can withstand the reputational aspects associated with a big piece of litigation. So yes, we might see more defences run to trial going forward. That's not to understate how difficult it is to tolerate three or four or five years of legal proceedings in a trial where very senior people give evidence and are cross examined. None of that is easy or pleasant. But this does feel like a change in the mood of corporate Australia on class actions where they can push back harder than perhaps has traditionally been the case.

A federal parliamentary inquiry is being held into class actions. Where is that inquiry up to and what do you hope to see in the findings?

The Committee released its 450+ page report on Monday 21 December 2020.

Generally, the recommendations impose further checks and balances on plaintiff law firms and litigation funders, to protect class members and ensure their returns are not unreasonably diminished in the event a class action is successful. The recommendations include:

- expanding the Federal Court's powers to resolve competing class actions, to order class closures and to make common fund orders;
- requiring litigation funders to indemnify representative plaintiffs and introducing a presumption that a funder will provide security for costs;

- requiring Federal Court approval for a litigation funding agreement to be enforceable (with powers of the Court to amend the agreement in the interests of justice);
- considering the introduction of a statutory minimum return to class members; and
- permanently legislating the changes to the continuous disclosure laws introduced earlier this year, that seeks to raise the bar for shareholder class actions by introducing a fault element.

These recommendations are the platform for actual legislative reform, the debate over which will proceed this year.

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KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.

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