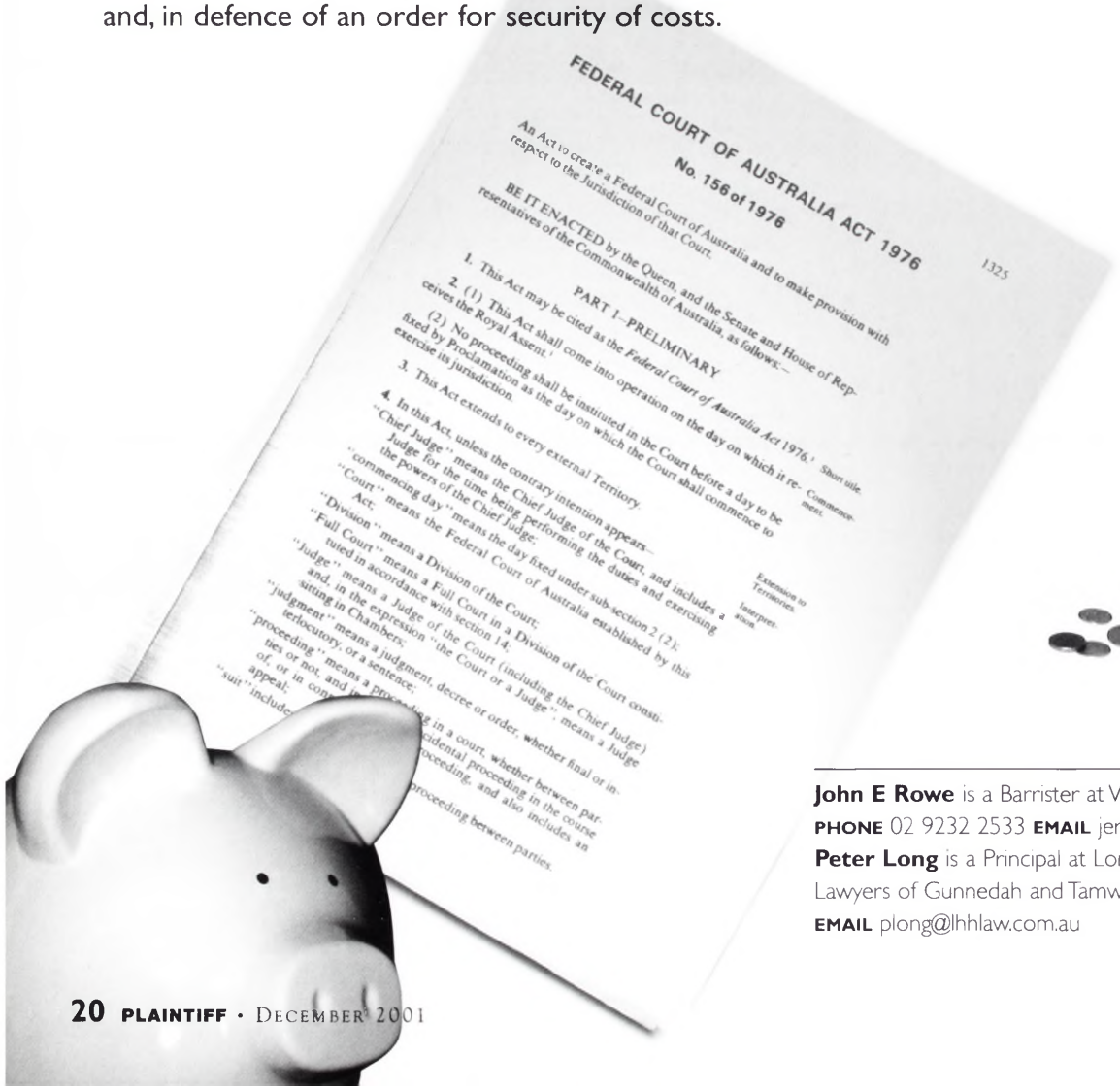
Security for *Costs*

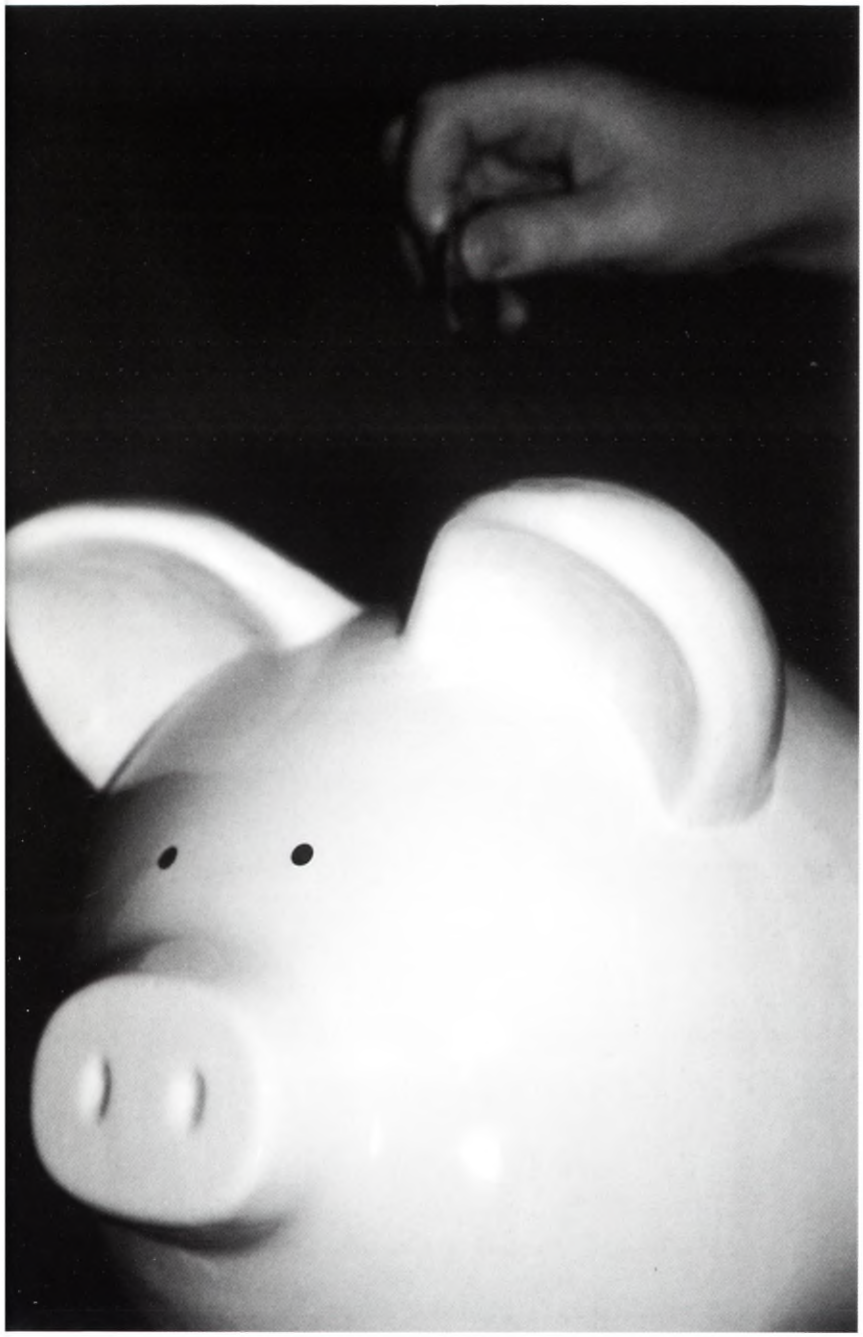
in representative actions in the Federal Court

Representative actions provide a means whereby those who would otherwise not have the means to pursue litigation have access to the court system. However, such actions have been criticised as providing insufficient costs protection for defendants, though such defendants are often among the most affluent members of the community and may regard the courts as their playground. This article identifies the legislation allowing security for costs orders in representative actions in the Federal Court of Australia, considers the judicial interpretation of such legislation, and discusses arguments that have been advanced in support of and, in defence of an order for security of costs.



John E Rowe is a Barrister at Windeyer Chambers, Sydney
PHONE 02 9232 2533 **EMAIL** jerowe@bigpond.com
Peter Long is a Principal at Long Howland Houston, Plaintiff Lawyers of Gunnedah and Tamworth. **PHONE** 02 6742 5018
EMAIL plong@lhhlaw.com.au

JOHN E ROWE, SYDNEY AND PETER LONG, GUNNEDAH



The Legislation

Section 56 (1) of the *Federal Court of Australia Act* 1976 gives the Court or a Judge a discretion to:

"Order an applicant in a proceeding in the Court ..... to give security for the payment of costs that may be awarded against him or her."

Subsections (2) and (3) deal with specification of the amount, manner and form of the security and the time of its provision. Subsection (4) provides that, if security is not given in accordance with an order under the section, "the Court or a Judge may order that the proceeding ..... be dismissed".

Order 28 of the Federal Court Rules deals with security for costs. Rule 2 requires applications for orders for the provision of security be made by a motion upon notice. Rule 3 (1) provides:

"Where, in any proceeding, it appears to the Court on the application of a respondent;

'(a) that an applicant is ordinarily resident outside Australia;

(b) that an applicant is suing, not for his own benefit, but for the benefit of some other person and there is reason to believe that the applicant will be unable to pay the costs of the respondent if ordered to do so; or

(c) subject to Sub-Rule (2), that the address of an applicant is not stated or is mis-stated in his originating process; or

(d) that the applicant has changed his address after the commencement of the proceeding with a view to avoiding the consequences of the proceeding,

(e) the Court may order that applicant to give such security as the Court thinks fit for the costs of the respondent of and incidental to the proceeding.'"

Interpretation

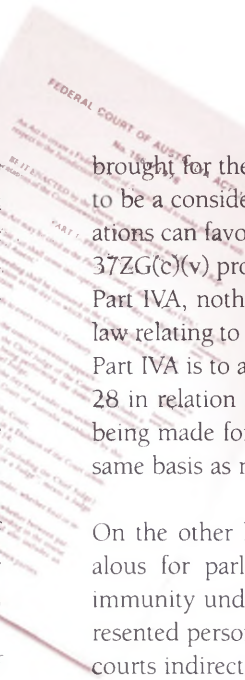
In *Bell Wholesale Company Ltd v Gates Export Corporation*,[1] the Full Court considered these two provisions. The Court rejected an argument that only circumstances in which security might be ordered were those specified in Order 28 Rule 3 (1). The members of the Court said the rules could not operate so as to limit the wide power conferred by Section 56. At paragraph 3 they said:

"The discretion to make orders under Section 56 must be exercised judicially, but that is the only relevant limitation. Moreover, it is plain from the terms of O.28 itself that R.3 is not intended to be an exhaustive statement of the cases in which an order for security for costs can be made. Rule 6 is quite inconsistent with such a proposition."

At paragraph 4 the Court said:

"In our opinion a Court is not justified in declining to order security on the ground that to do so will frustrate the litigation unless a company in the position of the appellant here establishes that those who stand behind it and who will benefit from the litigation if it is successful (whether they be shareholders or creditors or, as in this case, beneficiaries under a trust) are also without means. It is not for the party seeking security to raise the matter; it is an essential part of the case of a company seeking to resist an order for security on the ground that the granting of security will frustrate the litigation to raise the issue of the impecuniosity of those who the litigation will benefit and to prove the necessary facts."

This case has been applied in the Federal Court on innumerable occasions. ▶



In recent years, it has been necessary for the Court to determine the application of the above to representative actions. In *Woodhouse v McPhee*[2] such an action was brought by Woodhouse on behalf of himself and 97 other ex-employees of Wodonga Meats Pty Ltd. Woodhouse claimed the company had traded as an insolvent company under the control of its Directors, the three respondents, until it went into liquidation leaving monies due to its employees. Woodhouse accepted he was unlikely to be able to meet any order for costs but contended, according to Merkel J, "that the object of facilitating access to justice through the representative proceedings under Part IVA will be substantially undermined if the Court renders represented persons... indirectly liable for costs as a consequence of an order for security" on the basis of being pressured to contribute to a pool of funds.

Merkel J referred to Section 56 of the *Federal Court of Australia Act* and Order 28 Rule 3. He noted "the fact that a proceeding by an impecunious applicant is also brought for the benefit of others is a fact of which, in general, weighs in favour of ordering security for costs unless it is established that the order will stifle or stultify the proceeding or otherwise be oppressive". He also mentioned the comment of Burchett J in *Cunningham v Olliver*[3] where his Honour said:

> "The applicant's impecuniosity should not close the door of the Court against his claim. However, to the extent that the claim is put forward on behalf of others, it is appropriate to regard this principle as qualified."

In the course of his judgment Merkel J referred to a passage from the then Attorney-General's second reading speech on 14 November 1991 in support of the Bill that introduced Part IVA into the *Federal Court of Australia Act*. The Attorney-General said:

> "Such a procedure is needed for two purposes. The first is to provide a real remedy where, although many people are affected and the total amount at issue is significant, each person's loss is small and not economically viable to recover in individual actions. It will thus give access to the courts to those in the community who have been affectively denied justice because of the high cost of taking action.
>
> The second purpose of the Bill is to deal efficiently with a situation where the damages sought by each claimant are large enough to justify individual actions and a large number of persons wish to sue the respondent. The new procedure will mean the groups of persons, whether they be shareholders or investors, or people pursuing consumer claims, will be able to obtain redress and do so more cheaply and efficiently than would be the case within individual actions."

Merkel J then said:

> "Section 56 confers a broad discretion on the Court which is to be exercised by reference to the particular circumstances arising in each case. Accordingly, the Court should be cautious about enunciating general rules that might fetter that discretion. However, in my view there is no reason why, in general, the fact that a proceeding is brought for the benefit of others under Part IVA ought not to be a consideration which together with other considerations can favour the ordering of security. Indeed, Section 37ZG(c)(v) provides that, except as otherwise provided by Part IVA, nothing in the part affects the operation of any law relating to security for costs. Consequently nothing in Part IVA is to affect the operation of Section 56 and Order 28 in relation to security for costs or is to impede orders being made for security for costs in Part IVA cases on the same basis as may be ordered in other cases.
>
> On the other hand it would be incongruous and anomalous for parliament specially to confer a direct costs immunity under Section 43 (1A), inter alia to afford represented persons greater access to justice, and then for the courts indirectly to remove the effect of that immunity by making orders for security for costs on the basis that the applicant is bringing the proceedings for the benefit of others who ought to bear their share of the potential costs liability to other parties. In my view, in order to deal with that incongruity and anomaly the fact that an impecunious applicant is bringing a Part IVA proceeding for the benefit of represented persons, whilst a relevant consideration in favour of granting security, ought not of itself be as significant a consideration as it might otherwise be in favour of the granting of security."

Merkel J noted three considerations that operated against the making of an order for security:

> "the individual applicant has a bona fide claim and has a reasonable arguable case for relief under Part IVA of the Act in a matter which raises important issues of principle in relation to the rights of former employees of a company in liquidation;
>
> ..... public policy considerations weigh strongly against any order for security that might impede a group claim for accrued employee entitlements brought against Directors on the basis of their liability for insolvent trading by their company;
>
> ..... and order for security is likely to stultify proceedings unless the security is obtained from the represented party."

Merkel J later said:

> "The respondent accept the difficulty in obtaining an order for security for costs against an impecunious but bona fide individual applicant but have put their claim on the basis of the benefits to be derived from the proceedings by other employees. As pointed out above policy considerations derived from Section 43(1A) will usually dilute the significance of, and the weight to be given to, that consideration in a properly brought Part IVA claim. Even if, contrary to that view, I were to disregard these policy considerations, in the circumstances of the present case the importance of the issues raised by the claim and the public policy considerations to which I have referred above are of such

weight that I would nevertheless exercise my discretion against ordering security for costs.

There may be circumstances which arise in a particular case under Part IVA that may warrant a different approach to that set out above. For example if the claim was spurious, oppressive or clearly disproportionate to the costs involved in pursuing it or if the proceedings were structured so as to immunise persons of substance from costs orders I would not consider the fact that the represented persons were entitled to the benefits of Section 43 (1A) to be a consideration which in any way operates against an order for security in such cases."

Subsequently, in *Grant Ryan v Great Lakes Council & Ors*[4] the evidence clearly established that the applicant did not have sufficient means to meet the costs of the respondents in the proceedings if the respondents should win and the usual cost orders be made. The case involved personal injuries to persons eating contaminated oysters.

Wilcox J dismissed an application by the respondents for an order for provision of security for costs. In doing so his Honour referred extensively to the judgment of Merkel J in *Woodhouse* and adopted his views. His Honour said, inter alia:

"..... like Merkel J I think Section 43(1A) ought generally be regarded as a substantial impediment to the 'financial pool' approach urged by Mr Fagan. That approach would have the effect of exerting substantial pressure on group members to make a contribution to securing the respondent's costs, even though Section 43(1A) expressly exempts them from liability to meet those costs. Moreover it may do after the termination of the opt out period (see Section 33J of the Act). The group members may have decided to remain in the representative proceeding, and not opt out or embark on a separate action, in reliance of the protection afforded by Section 43(1A).

In agreeing generally with Merkel J, I accept his view about a claim that is 'spurious, oppressive or clearly disproportionate to the costs involved in pursuing it' or structured so as to immunise persons of substance. Mr Fagan does not suggest any of these strictures apply to these claims. I think this attitude is realistic. Whatever may be the ultimate failure of the claims, they are brought bona fide and on an arguable basis. In total, the claims are substantial. They are being conducted by the applicant's advisers in an efficient manner. Although the proceedings are necessarily complex, having regard to the number of parties involved, it should be possible to ensure their cost does not become disproportionate to the stakes."

Arguments in Defence of an Application for Security for Costs

One needs to establish, if possible, that the representative is a viable entity that continues to earn income, and that its claim is for real losses suffered as a result of the wrongful conduct of the respondent. The onus is on the representative to adduce the evidence of this viability if appropriate.

This allows the defence of the respondent's application for security for costs to be based on the following three points that flow from the decisions in *Woodhouse* and *Ryan* and the effect of Sections 56 and 43(1A) of the *Federal Court of Australia Act* and Order 28 Rule 3 of the Federal Court Rules:

1. It is inappropriate to make an order because of the applicant's financial standing.
2. Even if the applicant is found not to have sufficient financial standing it would be against public policy to make such an order in representative proceedings (Section 43(1A)).
3. In any case, in exercise of discretion the Court should not make an order.

Evidence in Support of the Defence

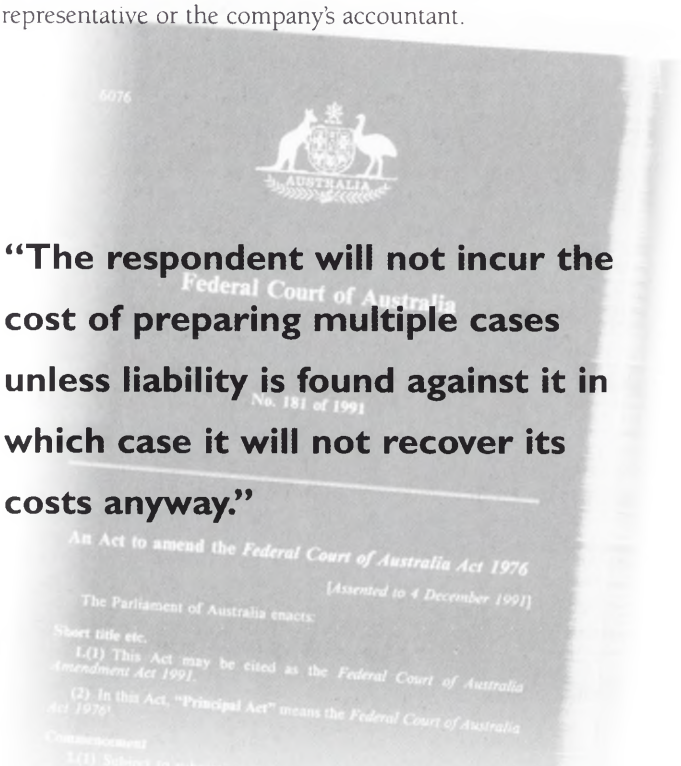
It will be necessary to obtain evidence of the following matters:

1. The applicant's financial standing. This will involve an outline of any business, formation of the company if a corporation, the applicant's fiscal performance, contracts, forecasts, and the effect on cash flow of the wrongful conduct of the respondent.
2. If a corporation, the financial capacity of the principals of the company.
3. The ability, or lack thereof, of the applicant to meet an order for security for costs and what will be the fate of the ▶

action should such an order be made and no security lodged.

4. An indication as to the nature of the case, the number of possible claimants and the size of claims, whether the claims are Australia wide. This evidence (which may be from the solicitor) is to establish the claim is not spurious, has a good chance of success, is not oppressive and the costs are not disproportionate.

The above evidence may be in the form of affidavits from the solicitor, the representative, a principal of the corporate representative or the company's accountant.



"The respondent will not incur the cost of preparing multiple cases unless liability is found against it in which case it will not recover its costs anyway."

Most of the representative proceedings run in the Federal Court have had liability determined first. If this precedent is followed in the future it will mean that most cases will be decided before incurring costs of preparing and presenting the individual claims of the rest of the class. The respondent will not incur the cost of preparing multiple cases unless liability is found against it in which case it will not recover its costs anyway.

Dealing with each aspect of costs usually raised by respondents in support of these applications:

1. If the application for security is successful the respondent may be entitled to its costs of the application which will be minimal and the order for security may bring the case to an end. If the respondent loses the application it will not be entitled to those costs.
2. Usually in its affidavit in support of an application for security for costs, the respondent foreshadows the usual raft of strike out motions at purported significant cost to it. If the respondent wins any of its proposed strike out applications it may bring an end to the litigation and costs at that stage will be reasonably low. If the respondent does not succeed on its strike out motions, it is unlikely it will recover its costs.
3. Often, the respondent's assessment of the likely costs to be incurred proceeds on a false premise, namely, that evidence of liability and quantum in all claims will be heard before the representative action is decided. It is not unusual for the respondent to put on affidavit evidence to the effect that there are numerous claimants throughout the nation and on that basis to extrapolate the respondent's potential costs out by the number of possible claimants whose claims will have to be processed. Commonsense indicates this is unlikely to be a correct basis of the assessment and is likely to significantly over-estimate the costs.
4. An examination of the affidavit evidence put on by the respondent often shows it has calculated an unsustainable figure for costs bordering on the ridiculous. The total witnesses as to fact for the respondent will not be hundreds and hundreds usually alleged as being involved in responding to the individual claims of the class, but a handful at the most required to give evidence on the common issue of liability and some of those will be the respondent's own personnel.
5. The documentary evidence will often be, contrary to the allegations made by the respondent in its evidence, just a few documents raised in relation to the liability claim of the applicant. The same goes for contentions that the hearing will go for 10 weeks or more. It will usually finish within 20 hearing days if the Court deals with liability first.
6. The affidavit evidence put on by the respondent often avers to it having to recover costs for multiple junior solicitors and paralegals in the preparation and presentation of the defence case, including touring Australia to gather the evidence of the hundreds of witnesses. Again such a contention is based on a misunderstanding of the way representative actions proceed.

Conclusion

The underlying rationale for a representative action is its own Achilles heel in that the same facility which gives a group of commonly affected citizens cost effective access to justice for often small amounts of compensation in respect of devastating personal or business injuries is attacked as providing insufficient costs protection by those who seek to make the courts the domain of the more deserving large corporations seeking millions of dollars in damages from each other. It remains to be seen whether the Court remains a forum provided by the Australian community for use by as many of its members as possible or a playground of the rich. The irony is that the Court is funded by the Chris Citizen taxpayer giving up to 40 percent of his or her earnings to the government coffers and those who complain loudest about representative actions often pay in taxes less than 5 percent of their earnings. PL

Footnotes:

1 [1984] 2 FCR 1
2 [1997] 1509 FCA (24 December 1997)
3 (21 November 1994, unreported)
4 [1998] 407 FCA (24 April 1998)