Class Actions and Litigation Funding – what’s all the talk about?

Class actions have historically been thought of as a US phenomenon. Over the last 5 years, however, class actions have increased in number in Australia and have now have become an established part of Australian litigation. Barely a day goes by without the press reporting the threat of a new class action.

The GFC ramped up the number of class actions that were launched and now, as the GFC is winding down, class actions are still continuing. The increase in frequency of class actions has coincided with the increase in litigation funders who financially enable the actions to take place.

Class actions provide efficiencies for the courts and an avenue for a typical individual to have access to the legal system in a cost effective manner. However, for Australian businesses and insurers there are some concerning trends in the number of actions and the quantum awarded which bear close scrutiny. At this stage, there are signs of challenging times ahead for insurers in this space.

Tort reform has so far been successful in reducing the activity in the courts for personal injury liability claims. As a consequence, an increasing number of plaintiff lawyers, particularly the larger firms, have turned their focus to class actions.

This article looks briefly at the history of class actions and litigation funding in Australia and wraps up with the implications for the insurance industry. It highlights the areas that businesses, and particularly insurers, should be thinking about.

What makes up the “Class Action Industry”

Australia’s “class action industry” is driven by the interaction of:

- Courts facilitating the consolidation of claims or class actions
- The financing of the cost of running class actions through litigation funding.
- Plaintiff lawyers being active in identifying and gathering groups of claimants
Insurers end up paying out large portions of the settlements via Professional Lines and Public Liability policies. Directors and Officers Insurance has been the major class hit by class actions in recent years, but is not the only type of insurance impacted.

Class actions are a big business for plaintiff lawyers and litigation funders. Litigation funders typically receive around 30% of each settlement. A plaintiff law firm’s fees can be $10 million plus for some actions.

Approximately half of class actions are financed by litigation funders. 54% of class actions settled in 2012 were funded. Other actions may be funded by institutional investors.

What are Class Actions?

A class action is a form of lawsuit in which a large group of people or companies collectively bring a claim to court. The main benefit of class actions is that they enable a dispute involving large numbers of people to be resolved by way of a single case. Class actions provide access to justice for a large number of consumers who would otherwise have difficulty in having their claims heard and assessed.

To start a class action the following is required:

- 7 or more members or groups
- Each member has a claim against the same person or entity
- Claims arise out of the same or similar circumstances, with a substantially similar legal issue of law or fact.

We look at the history of class actions and look at the specific details of class actions later in this article.

What is Litigation Funding?

Bringing legal action is a costly process, both in preparing and running a case, and then with the risks of paying the other side’s cost if the case is lost. When a case involves numerous claimants for relatively small amounts each, the chance of the group funding the case is small, and the likelihood of the group accepting the risk of a costs order against it is even smaller.

Australian lawyers are prohibited from entering into contingency fee arrangements with their clients, however, litigation funders are not so constrained. Litigation funders have seized this opportunity by providing funding for cases where the damages claimed are large. The funders take a cut of the settlement, typically 30%, but also provide security to the claimants and plaintiff lawyers.
if adverse cost orders arise. The participation of a litigation funder reduces risk to both the
claimants and plaintiff lawyers.

Litigation funders originally existed for funding insolvency litigation, but moved into non-insolvency
cases just over 10 years ago. In 2001, Australia’s largest litigation funder, IMF, expanded to fund class
actions and also listed on the stock exchange. Since then the number of litigation funders has increased to at
least 8, including overseas entrants. Litigation funders have now become integrated with class
actions. One of the leading plaintiff law firms has announced its own litigation funding business.

The reaction to litigation funders has been varied with some arguing they were not operating
legitimately, were abusing the process and should be outlawed. However, the government
appears supportive of litigation funders as they believe they provide better access to the legal
system for individuals.

We expect the scale of litigation funding to continue to increase due to

- the light touch regulation and supportive government,
- the increasing number of class actions, and
- the big potential profits involved.

**Impact on Businesses**

Class actions provide “accessible justice” for individuals but they are of significant concern for
directors because of the scale of litigation involved. The cost to defend the actions can be tens of
millions of dollars and settlements in the hundreds of millions. However, the impact extends
beyond the cost of the settlement and involves significant amounts of directors’ and executives’
time. The reputation of the business and the individuals is also at stake.

It may be for this reason that the majority of class actions are ultimately settled before reaching a court verdict.
Brief History of Class Actions

Class actions have been available in Australia for 21 years. The timeline highlights the key events for class actions.

Class Actions Timeline

- **Mar 1992**: Available in Australian Federal Court
- **Jun 1992**: First class action filed
- **1999**: First securities class action filed (AMP/GIO)
- **Jan 2000**: Available in Victoria
- **2000**: 2012 Largest settled class action (Centro $200m)
- **Mar 2011**: Available in NSW
- **Today**: Western Australian law reform is expected soon to make class actions available.

The Federal Court was the first to make class actions available in Australia, in 4 March 1992. The Federal court remains the most favoured jurisdiction to raise a class action. The Supreme Court of Victoria was next to make class actions available, in January 2000. The Supreme Court of NSW has been open to class actions since March 2011, although this jurisdiction has been rarely used to date.

Western Australian law reform is expected soon to make class actions available.

The first class action was filed 3 months after class actions were made available, but they were slow to take hold. Lawyers eventually began to recognise the benefits offered by the new class action procedure and the rate of filings increased. Initially product liability claims were the focus, however, a number of well-publicised and expensive defeats saw the leading plaintiffs’ firms shift their attention to focus on shareholder and financial services-based claims.

In 1999, the first securities or shareholder class action took place against GIO/AMP in respect of misleading information provided during the takeover. This case set the scene for many more securities class actions to follow. 2012 saw the largest ever class action settlement in Australia of $200 million for Centro shareholders, bringing to an end more than four years of complex and expensive litigation.

Australia has also made its mark on the class action stage worldwide, with its perceived plaintiff-friendly regime and a thriving class action industry driven by an active litigation funding sector. As a
result some lawyers believe, outside of North America, Australia is the place where a corporation is most likely to find itself defending a class action.

The impact of litigation funding on the class action industry has been profound, and the class action landscape has moved well beyond anything that was imagined when the regime was introduced in 1992.

Overlaying the key events for litigation funding over the class action timeline we can see how litigation funders are becoming an accepted and legitimate part of the class actions industry.

Litigation funders have been funding insolvency cases since at least 1997. It was in 2001 that IMF started funding class action cases. Litigation funders were challenged in 2005 and 2006 with arguments that funders should require an Australian Financial Services Licence (AFSL). In 2006 a high court decision (Fostif) accepted funders as legitimate.

In 2012 litigation funders received a permanent exclusion from needing an AFSL (except IMF which as a listed company has chosen to continue a licence). This has legitimised litigation funders in Australia allowing them to operate under minimal regulation. Funders only need to apply a set of conflict management processes. There is no capital or other requirements for litigation funders. Supervision of funding falls back to the courts as part of the overall legal management of the actions.
IMF, being the largest litigation funder in Australia, has funded some of Australia’s most high profile class action cases including Aristocrat, Centro, Pan Pharmaceuticals, AWB and the Bank Fees class actions. Over the last 10 years, IMF says it has recovered over $1 billion in damages for its clients. For the $200 million Centro action, IMF received $60 million in revenue and booked a before tax profit of $41.8 million.

In early 2013, a major plaintiff law firm, Maurice Blackburn, started a new litigation funding company which will be used to fund some of the class actions they act in. This complicates the issues of conflict of interest and may create a new dynamic for the class action industry.

### Notable Class Actions

There have been some significant cases flooding the media over the last 10 years. The dollars attached to these cases are clearly eye catching.

<table>
<thead>
<tr>
<th>Case</th>
<th>Allegations</th>
<th>Date Filed</th>
<th>Date Settled</th>
<th>Amount</th>
<th>Funded</th>
<th>GFC?</th>
<th>Insurance Cover</th>
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<tbody>
<tr>
<td>GIO</td>
<td>Misleading info in takeover</td>
<td>1999</td>
<td>2003</td>
<td>$112m</td>
<td>N</td>
<td>N</td>
<td>D&amp;O</td>
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<tr>
<td>Aristocrat</td>
<td>Continuous disclosure &amp; deceptive conduct</td>
<td>2003</td>
<td>2008</td>
<td>$144.5m</td>
<td>Y</td>
<td>N</td>
<td>D&amp;O</td>
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<tr>
<td>Multiplex</td>
<td>Continuous disclosure</td>
<td>2010</td>
<td></td>
<td>$110m</td>
<td>Y</td>
<td>N</td>
<td>D&amp;O</td>
</tr>
<tr>
<td>Centro</td>
<td>Continuous disclosure &amp; deceptive conduct</td>
<td>2008</td>
<td>2012</td>
<td>$200m</td>
<td>Y</td>
<td>Y</td>
<td>D&amp;O / PI</td>
</tr>
<tr>
<td>Bushfires (4 actions)</td>
<td>Negligence</td>
<td>2009</td>
<td>2013</td>
<td>Est $100m</td>
<td>Y</td>
<td>N</td>
<td>PL</td>
</tr>
<tr>
<td>ABC Learning</td>
<td>Continuous disclosure &amp; deceptive conduct</td>
<td>2008</td>
<td>TBC</td>
<td>Est $100m</td>
<td>Y</td>
<td>Y</td>
<td>D&amp;O / PI</td>
</tr>
<tr>
<td>Bushfires (3 actions)</td>
<td>Negligence (Victorian Bushfires)</td>
<td>2009</td>
<td>TBC</td>
<td>Est 1bn</td>
<td>Y</td>
<td>N</td>
<td>PL</td>
</tr>
<tr>
<td>Lehmann Bros</td>
<td>Misrepresentation of products</td>
<td>2009</td>
<td>2012</td>
<td>Est$211m</td>
<td>Y</td>
<td>Y</td>
<td>FI</td>
</tr>
<tr>
<td>Wivenhoe</td>
<td>Negligence (Dam flooding)</td>
<td>2012</td>
<td>TBC</td>
<td>Est 1bn</td>
<td>Y</td>
<td>N</td>
<td>PL</td>
</tr>
<tr>
<td>Banks Fees (ANZ)</td>
<td>Unfair fees</td>
<td>2010</td>
<td>TBC</td>
<td>Est$220m</td>
<td>Y</td>
<td>N</td>
<td>FI</td>
</tr>
</tbody>
</table>

Source: Media publications

Centro is the largest class action settled to date at $200 million.
Type of actions

The subject matter of Australian class actions has varied over the past 20 years. As we noted earlier class actions were used to settle mass tort or product liability disputes. The start of the new millennium saw a trend towards class actions being commenced to settle shareholder and financial services disputes.

The majority of actions over the GFC were in respect of breaches in the continuous disclosure requirements or misleading conduct. However, in the last few years Australia has seen a return of product liability claims with recent filings focusing on defective food, medical devices, pharmaceuticals and other consumer claims.

Aristocrat is an example of a securities class action made in respect of failure to disclose and misleading conduct. This action occurred in 2003 and has been one of the largest to date, settling at $144.5 million in 2008. In this case Aristocrat made statements of profit forecasts that were overstated, misleading and deceptive therefore breaching accounting standards and the Trade Practices Act.

Centro, the largest class action paid to date ($200 million), related to a breach of disclosure during the GFC. A currently ongoing class action against Lehmann Bros has been made by a number of councils in respect of misrepresentation of investment products which resulted in the councils losing significant funds during the GFC.

Cases in respect of negligence include the 2009 Black Saturday Victorian Bushfire class actions (7 actions have been made so far separating the regions impacted) and 2011 Wivenhoe Dam flooding. In both of these cases a significant number of impacted individuals have potential actions.
in respect of negligence against utility companies and government bodies involved. Only 4 out of the 7 class actions for the bushfires have been settled, totalling approximately $100 million. The remaining bushfire and Wivenhoe dam actions are ones to watch, with amounts of $1 billion each being sought.

Unfair bank fees has been a recent area for plaintiff lawyers to test in respect of consumer fairness. Bank customers holding 240,000 accounts with claims in excess of $250 million against 12 Australian banks have now entered into litigation funding agreements with IMF. The first class action has been launched against ANZ, the outcome of which will pave the way for the other actions.

Who is being sued?
The defendants or those being sued come from a variety of companies and organisations.

The losses arising from the GFC have generated more claims against financial services companies and advisers. Lehman Bros, Babcock & Brown, Storm Financial and NAB have all been hit by class actions arising from GFC impacts. However, these are not the only companies being hit during times of economic turmoil.

Any company listed on the stock exchange is at a higher risk during these times. Centro (a retail and property manager), ABC learning (a provider of early childhood services) and Sigma Pharmaceuticals were all hit by class actions as a result of shareholders losing money off the back of the stock market falls.
Large companies providing consumer products are at risk of negligence claims. Pan Pharmaceuticals ended up paying a $122 million class action from the follow on effects of its pharmaceutical licence being suspended.

Utility companies and government agencies have been in the spotlight for the Victorian Bushfires and the Wivenhoe dam flooding actions. It seems that even government agencies are not immune from being brought in to defend actions. Multiple parties have been brought into these actions, for example, for the major Victorian bushfires class action (Kilmore East-Kinglake Bushfire Class Action) the following defendants have been named:

1. SPI Electricity Pty Ltd
2. Utility Services Corporation Ltd
3. Secretary of the Department of Sustainability and Environment
4. Country Fire Authority
5. State of Victoria

The rating agencies are also in the firing line with the Federal Court making a world-first finding against rating agency S&P over negligence in its rating of CDOs - a decision that is likely to have global implications.

Class Action Trends

Until recently, there have been extremely limited statistics on class actions. We have therefore had to piece together statistics to assist with understanding trends in the number and quantum of the actions.

King & Wood Mallesons produced a recent update showing security class action settlements totalled $480 million in 2012. The significant cost of security class actions alone over the last 20 years has now totalled $1 billion.

Figure 1: Significant securities class action settlements

Source: Class Actions in Australia – The Year in review, King & Wood Mallesons
An academic study by Professor Vince Morabito was released in 2012 showing the number of class actions filed by year, but only up to 2009.

The chart shows the results of the study and suggested that actions appeared to be under control, after a slow start, with a rush of cases in the late 90s, with limited success resulting in a downturn in the 2000s.

On average there were 16.5 class actions filed per annum to 2009. However, there is a big question around what the numbers look like after 2009. All indications suggest an increase.

….but all indications suggest a dramatic increase since 2009.

To monitor more recent trends we have compiled an information base of cases pursued by litigation funders and notable in the media. The listing below only includes high profile class actions, so we would expect the actual number of actions filed in the year to be higher when accounting for the cases not publicised.
We have noted 13 new class actions over 2012/13, 12 of which are non-GFC related. This suggests that the majority of GFC related class actions have already started and the current activity is coming from a more stabilised economy. Nine actions have settled over 2012/13, mainly GFC related. Actions take, on average, about four years to settle.

The cases settled in our information base average a settlement cost of $45 million. There are many possible outcomes for the 43 active cases. If they settle at an average of $45 million then this would mean another $2 billion could arise from these cases.

While insurers will only pay a portion of each settlement, the cost to insurers is going to be substantial. Insurer contribution to class actions is largely unknown, however in a couple of the larger cases we do have some information:

- **Aristocrat**  $100 million out of the $144.5 million was paid by insurers
- **Centro**  $60 million out of the $200 million was paid by insurers
Emerging Issues

Privacy Laws

Privacy laws have tightened with the 2012 Privacy Amendment Bill, which puts companies at a higher risk of breaching laws of negligence or deceptive conduct.

The statistics below make this an area for businesses to get on top of:

- “One in five Australian business hit by a data breach” (McAfee 2013)
- “Australian businesses surveyed spent an average of US$2.27 million dealing with data breaches” (Ponemon)
- Organisations are slow to self-detect data breaches
  - Average time to detect a data breach is 210 days
  - 64% of organisations take over 90 days to detect an intrusion
  - 5% of organisations take three or more years to identify criminal activity

Insurance companies have responded by offering 'cyber insurance' as a separate product to deal with the increase in cybercrime and tightening of privacy laws.

US Impacts

Big legal firms across the globe have begun co-operating with Australian law firms to share information and learnings. Employment issues have been a recent area of class actions in the US, which we may see here in the near future.

US trends may flow to Australia. Will employment action be next?

Regulation

Australian regulators such as ASIC and the ACCC are providing opportunities for class actions and in some cases running actions themselves. Where regulators publically fine companies, there is clearly an opportunity for actions to be raised.
What are the implications for insurers?

The implications for the insurance industry are significant. Given the large claims cost relative to premiums, there is a real risk of significant claims costs for the industry.

Exposure

If we think about the Arisocrat case where insurers paid $100 million of the $144.5 million settlement, this was relative to a premium pool of about $700 million for professional indemnity and $250 million for D&O. It does not take many of these claims to wipe out the whole premium pool.

Underwriters will be conscious of limiting coverage and having tight policy wordings in this area to minimise losses. Insurers should be aware of accumulations to particular industries and advisers.

Pricing and Reserving

The high severity and low frequency of class actions means that it is best treated like a catastrophe allowance in pricing these risks. As yet, we are yet to see class actions explicitly allowed for in pricing. Insurance classes covering class actions have historically run at profitable levels before the GFC. Despite this, the increase in competition and large class action payouts may mean class actions warrant specific attention in the pricing for insurers to remain ahead of the curve.

The insurance market faces challenges in recognising the cost of known class actions early on in the processes, given the uncertainties. This can result in claims cost being recognised in the accounts of well after the class actions have commenced. Therefore the profitability of the industry may be understated to date and it will take a number of years for the underlying cost of class actions to emerge.

Treat class actions like a catastrophe in pricing and modelling.