Allens > < Linklaters

Class Action Risk 2016

Allens > < Linklaters

Class actions have featured frequently in the press in recent years, often with a theme of a developing crisis for Australian business. In part, this attention has been driven by the fact that class action activity has significantly increased. The increase in filings is, however, only one part of the equation – a proper assessment of class action risk requires a more holistic assessment of the class actions landscape.

To provide that bigger picture, and give practical guidance to those responsible for managing class action risk, we have updated and built on the ten-year survey of the class action landscape we first published in 2015. In this report, we have looked at changes in the class actions landscape since 2005 with a particular focus on the past eighteen months, in order to provide a framework for a holistic and data-based assessment of class action risk. We have also identified some of the potential agents for change in the short to medium term and suggested a framework for considering and assessing class action risk.

KEY POINTS

- Class action risk has increased significantly over the course of the past decade – more claims are being filed and more law firms and third party funders are promoting claims.
- That trend does, however, need to be seen in its broader context. A closer analysis of the data reveals that the number of companies facing class actions has fallen.
- The key driver for the increased filings is the number of 'new' law firms who have commenced class actions. This 'new entrant' risk is currently a bigger contributor to class action risk than third party litigation funding.
- There has been a spike in shareholder class actions against listed companies in the past eighteen months, but longer term trends suggest that banks and financial services companies are the most frequent targets.
- There has been a renaissance of product liability claims (largely in the pharmaceutical and automotive industry) and natural disaster (mainly bushfire) filings continue to increase.
- The vast majority of class actions are settled, but almost one-third are dismissed or otherwise discontinued. This suggests that so-called 'blackmail settlements' are not as common as some suggest.

Contents

The big picture – class action filings

While class action filings have been 'lumpy', there is a clear upward trend. Filings in the past eighteen months continue, and consolidate, this trend. Indeed, the number of filings has been consistently at the high end of the range in recent years and a new baseline seems to have been set.

The peaks have been in 2014 and 2015 with 35 and 34 claims filed respectively. Unless there is a rush of filings in the next few months, 2016 filings are likely to fall below that level.

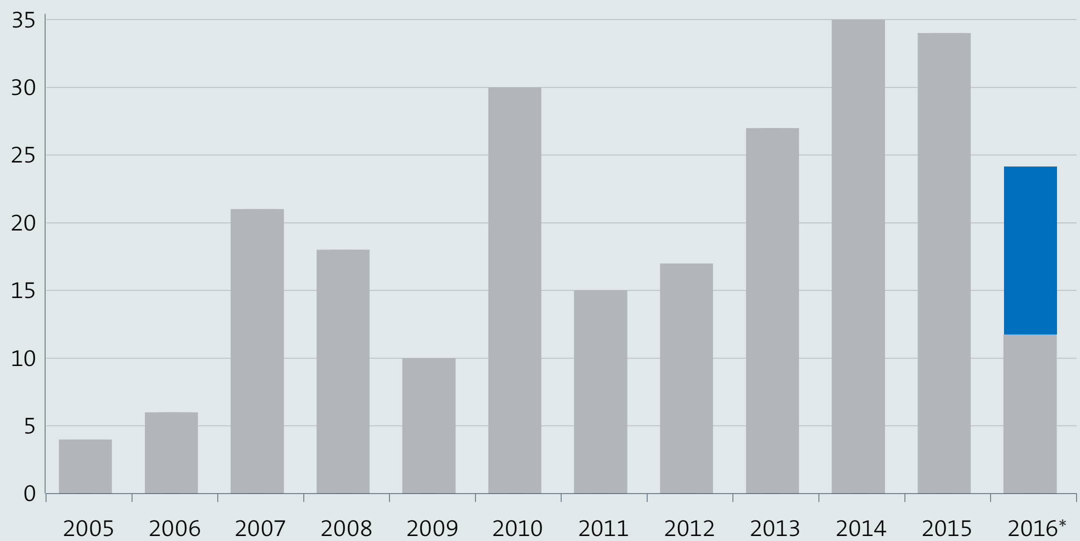
As discussed further below, the most significant contributor to this trend has been the number of law firms looking to establish class action practices and taking an entrepreneurial approach to identifying and promoting claims. This 'new entrant' risk has been a defining feature of the class actions landscape in recent years and, contrary to common perception, has had a materially greater impact on class action risk than third party funding.

A meaningful assessment of class action risk does, however, require this upwards trend to be considered in context. Of particular relevance in this respect is the way in which the trend has been significantly affected (and arguably distorted) by multiple claims in relation to the same or related conduct. Indeed, of the 46 class actions commenced in the eighteen months to June 2016, only 27 were the first class actions in relation to the conduct in question. When this fact is accounted for, it becomes apparent that the number of companies facing new class action activity in recent years has fallen quite substantially.

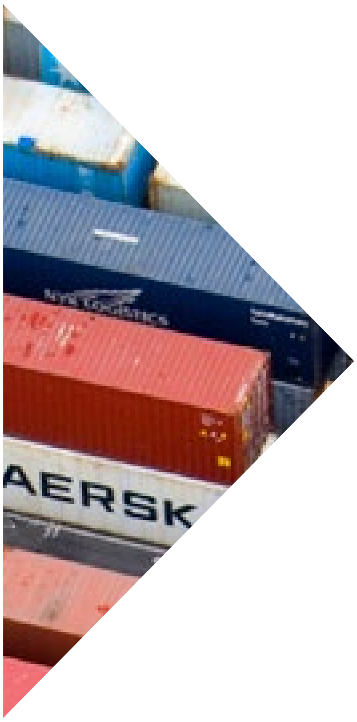
To elaborate:

- **Cluster claims:** We define clusters as class actions relating to the same or similar issues, often against the same defendant and usually filed by the same law firm. Most recently, eight class actions have been commenced against Standard & Poor's in respect of its rating of various CDOs. Other examples include the eleven bank fees class actions against the major banks and six class actions in relation to the Black Saturday bushfires.
- **Competing class actions:** The defining feature of competing class actions (as compared to clusters) is that they are filed by different law firms. The involvement of separate legal teams means that they often involve differently framed allegations and different settlement expectations – as a result, they are generally regarded as more problematic than cluster claims. Competing claims arise most frequently in the shareholder class action context, including the claims against Treasury Wine Estates, Worley Parsons and Vocation. Another recent example is the class actions against Volkswagen and its associated entities in relation to emissions devices.

Figure 1: Class actions filings 2005 – June 2016



* Forecast based on filings to June 2016.



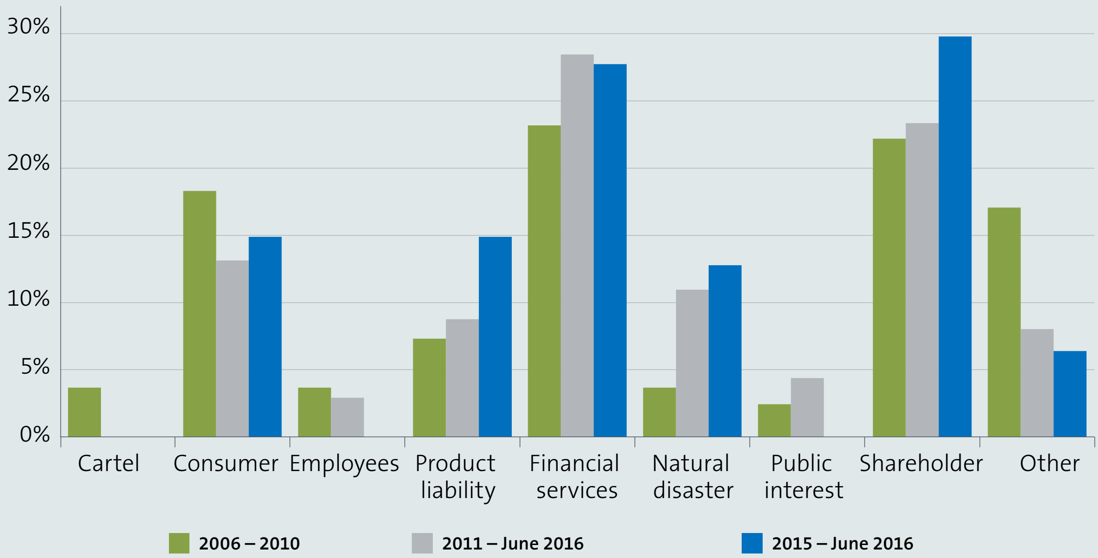
There can be no denying that cluster and competing claims create their own complications, frustrations and additional costs for the companies facing them, but a company facing two (or more) competing or cluster class actions does not face twice the exposure or costs burden of a single class action – there is often no additional exposure (as, in most cases, the claims could have been brought as a single class action) and the additional costs burden will vary depending on how the cases are managed (but can be significant).

We also make the following observations about class action filings, all of which are relevant to an understanding of the overall class action landscape and associated risk:

- While class actions are often considered to be high-profile claims involving hundreds or thousands of group members, there need only be seven group members. Our research indicates that class actions continue to be filed across the full spectrum from high-profile mega-litigation to minor cases which attract little (if any) public attention.
- We continue to see more claims being filed in the Supreme Courts of NSW and Victoria. Supreme Court filings accounted for more than 36 per cent of class action filings in the period from 2011 to June 2016; compared with about 17 per cent of filings in the period from 2005 to 2010. This is partly a reflection of the fact that the Supreme Court of NSW did not have an equivalent (ie Part IVA style) class action regime until 2010, but also of the increase in class actions based on allegations of negligence (such as natural disaster claims) and breach of contract (such as claims by dissatisfied consumers) which can generally only be run in state courts.
- Class action filings are increasing in an environment in which there has been a moderate, but sustained, decline in the number of civil filings in superior courts. This is most likely a reflection of the fact that the potential economies of scale of a class action create a viable risk-reward proposition for class action promoters in circumstances in which the costs of litigation are becoming an increasing deterrent for non-representative litigation. Indeed, class actions are much more likely to be driven by the entrepreneurial pursuits of lawyers and funders than other litigation.

Which sectors are most at risk?

Figure 2: Class action filings by type



A picture of the class action risk faced by particular types of organisations and industry sectors can be obtained by drilling down into the types of class actions being filed.

Figure 2 highlights the significant spike in shareholder class actions in relation to the market-disclosures made by listed companies in the past eighteen months (as a percentage of overall filings). While the trend is stark and undoubtedly a cause for concern for listed companies, it is important not to place too much emphasis on short term trends. This is particularly the case given that only just over half of the shareholder class actions commenced during that period were the first claims to be commenced in respect of the conduct at issue – the balance are competing claims of the kind discussed above.

Claims in the financial services sector are the most common type of claim based on longer term trends. The most frequent claims made against participants in this sector include claims relating to the mis-selling of financial products, the rating of financial products, lending practices and compliance with trustee obligations.

While this trend is of obvious concern to that sector, it is, once again, important to consider it in context. For example, filings in this sector have been affected by the bank fees cluster (of eleven claims) and the eight claims against Standard & Poor's referred to above – these cases have a very significant and disproportionate impact on the overall trend. It remains to be seen whether filings in this sector are sustained in the years to come, particularly as the limitation periods in respect of GFC-related losses expire. Indeed, as can be seen from Figure 2, financial services class action filings have fallen (as a percentage of overall filings) in the past eighteen months.

Just as importantly in putting the raw data in context is the fact that, while financial services class actions can be very significant and high-profile (such as the claims referred to above), this is the sector most likely to face smaller class actions (in terms of the number of group members, amounts claimed and public interest).

Other trends highlighted by Figure 2 include:

- The renaissance of product liability cases has continued. Although initially driven by medical devices and pharmaceutical claims, the recent trend has been driven by claims in the automotive industry. It is, however, a trend that all organisations in the manufacturing and distribution sectors should be aware of.
- The number of natural disaster class actions (specifically flood and fire cases) continues to grow. This is most likely to be of concern to government, electricity companies and the operators of public infrastructure. It is, of course, also of broader interest to the insurance sector.
- Although there has been a slight dip in consumer claims in recent years, they remain fertile ground for class action promoters. The claims in this category have included, by way of example, food poisoning, negligence in professional services, claims against payday lenders and claims by persons affected by a gas leak.

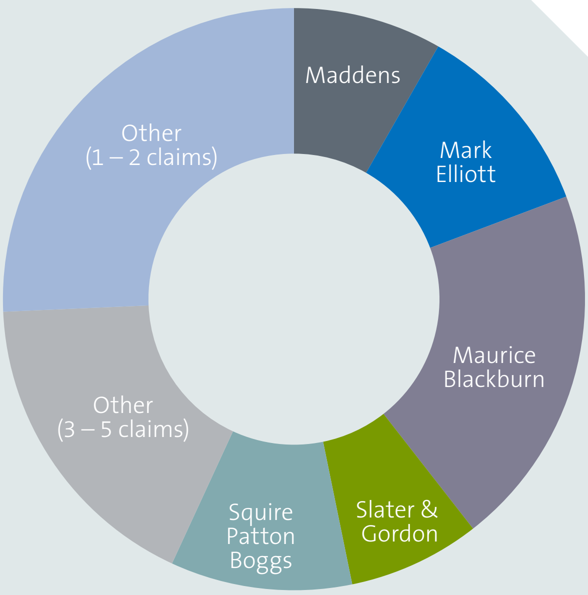
New entrants are driving the trend

As mentioned above, the defining feature of the class actions landscape in recent years has been the number of additional law firms bringing class actions. Not only has this trend resulted in increased filings, but 'new entrants' are also a core contributor to the trend for competing claims and, in our view, to class action risk.

Long term trends suggest that Maurice Blackburn and Slater & Gordon have been the most significant players, but more recent trends disclose a very different picture.

As can be seen from Figure 3, approximately 20 per cent of filings since 2013 can be attributed to Maurice Blackburn. Roughly 54 per cent of claims can be attributed to eight firms that have filed three or more claims during that period – all of which, with the exception of Slater & Gordon, are not traditionally known as plaintiff class action firms. The remaining 26 per cent is attributed to 15 firms who have filed either one or two claims since 2013.

Figure 3: Who is bringing class actions?



The main driver for this trend is a small number of firms attempting to establish repeat class action practices. In the case of Maddens and Squire Patton Boggs, this is off the back of success in particular types of claims (natural disaster and financial services, respectively). Mark Elliott (who is responsible for more claims than anyone other than Maurice Blackburn) focuses on shareholder class actions after acquiring shares in 675 publicly listed companies through a related corporate entity. Mr Elliott was responsible for six of the 14 shareholder class actions filed in the past eighteen months. Slater & Gordon has commenced seven per cent of the claims filed since 2013.

The trend is also being driven by other firms with little or no class actions experience bringing their first or second class action. This is undoubtedly resulting in claims at the more speculative end of the spectrum and is therefore an obvious contributor to risk. Moreover, in our experience, the relative inexperience of these firms in the class action context has the potential to create significant practical and reputational issues for the defendants they sue. To a large extent, these issues arise from the fact that class action law and practice is now heavily embedded in hundreds of interlocutory judgments and orders to the point where even the most careful reading of the legislation will give rise to misconceptions as to accepted and required practice. Defending claims run by firms who are not familiar with that practice requires particular insight and vigilance.

Many of these 'new entrants' are unlikely to have a sustained impact on the class action landscape in the years to come. It is, however, likely that some will be able to build on the experience of their first case to become repeat players. As they become more experienced, they are more likely to develop relationships with litigation funders which will expand their capacity to bring claims in the future. This has the potential to further increase class action risk.

It remains to be seen how this trend may be affected if the law is changed to allow lawyers to charge contingency fees (as discussed further below). The one certainty is that offering lawyers the opportunity to be remunerated by reference to a percentage of the outcome of class action litigation is not going to reduce the number of firms looking to get a slice of the action.

How are class actions resolved?

The vast majority of class actions are settled – this has been a long term and enduring trend.

Of the class actions filed between 2005 and June 2016 that have been resolved, approximately:

61% were settled

34% were dismissed or discontinued, discontinued as a class action or permanently or temporarily stayed

5% were the subject of a final judgment

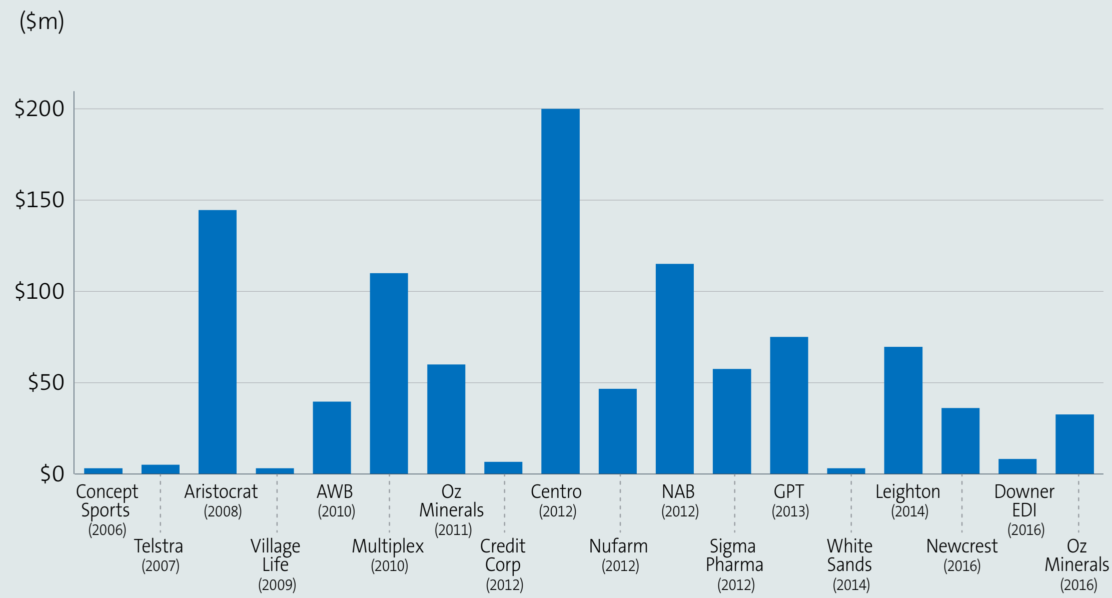
The percentage of claims settled rises to 70 per cent in respect of claims that have been publicly identified as third-party funded.

Aside from the high percentage of settlements, the statistic most relevant to class action risk is the 34 per cent of claims that have been dismissed or otherwise not continued without any payment by the defendant – the vast majority of these claims have been brought by the more inexperienced class action law firms. Particularly in circumstances in which the prospect of an adverse costs order is a deterrent for the commencement of truly spurious class actions, this suggests that Australian companies are generally 'knocking-out' the ill-advised claims that are commenced rather than entering into what are often described as 'blackmail settlements'. That is not, of course, to say that claims with limited prospects are not being settled to avoid the publicity, costs and distraction of dealing with a class action. Nor that significant costs are not being incurred before nuisance claims are dismissed or discontinued.

Much has been said about the recent record settlements in the Black Saturday bush fire cases (of $794 million), including that they are indicative of a worrying trend of ever increasing settlement amounts. In our view, caution needs to be exercised in leaping to conclusions of this kind. Indeed, it is difficult to draw meaningful inferences about trends from settlement amounts. So much depends on matters specific to each case – the size of the class, the apparent strength of the case, the quantum of alleged losses, the motivation of the parties to settle, whether a third party funder is looking for a quick return, the precedential value (or risk) of the case, the point in the litigation at which the case settled – to name just a few.

To illustrate this point, in Figure 4 we have set out the amounts for which various shareholder class actions have settled. In our opinion, there is no discernible trend that can be drawn from these figures.

Figure 4: Shareholder class action settlement amounts



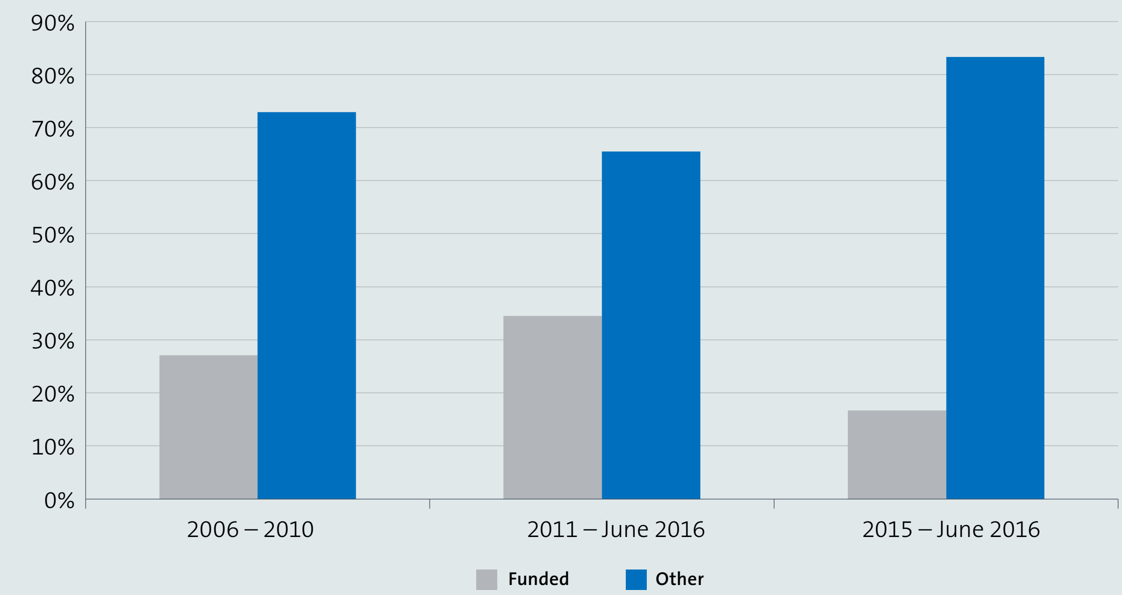
What effect is third party funding having on class action risk?

Over the course of the past decade, third party funders have become an increasingly entrenched, and accepted, participant in the Australian class actions sector.

While long term trends indicate a sustained increase in the percentage of class actions that are third party funded, that percentage has fallen in the past eighteen months. This is a direct consequence of the number of claims being brought by less established class action firms, who are much more likely to commence class actions without third party funding. Our research shows that the vast majority of funded claims are conducted by the firms referred to above as repeat players in the market.

Approximately 35 per cent of the claims filed in the period between 2011 and June 2016 were publicly identified as third party funded claims, compared with 27 per cent of claims filed in the period between 2005 and 2010. However, less than 20 per cent of the claims filed in the past eighteen months have been publicly identified as funded.

Figure 5: Third party funding



Of the funded class actions filed between 2011 and June 2016:

45% were funded by IMF Bentham Limited

18% were funded by other local funders (including LCM Litigation Fund, Litman Partners, Litigation Lending Services and Legal Justice)

37% were funded by offshore funders (including Comprehensive, International Litigation Funding Partners, International Litigation Partners, Litigation Capital Partners, Harbour, Argentum and Omni Bridgeway)

There is no doubt that third-party litigation funding has had a significant and sustained impact on class action risk. However, anecdotal evidence suggests that the commercial imperatives of funders play a role in moderating the enthusiasm of entrepreneurial plaintiff lawyers for a claim that might not be viable having regard to prospects of success, likely costs and the potential return on investment. That is because, unlike lawyers who are often remunerated for running a case irrespective of the outcome, it is usually all downside for the funder unless it can get a settlement or favourable judgment. That said, the impact of that role has been diluted as more funders – including some with more aggressive risk appetites – enter the market.

Interest in the question of possible further regulation of the third party funding market was renewed following the Productivity Commission's recommendation in December 2014 that funders should be subject to a licensing regime which focuses on capital adequacy and disclosure requirements. While there have been no developments since that time, we understand that it remains on the government's agenda. A licensing regime would inevitably impose a barrier to entry (or to continued operation) for current and would-be funders. The extent to which such a barrier may impact the availability of class action funding is likely to depend on how the offshore funders (which currently comprise just over one-third of the funding market) respond.

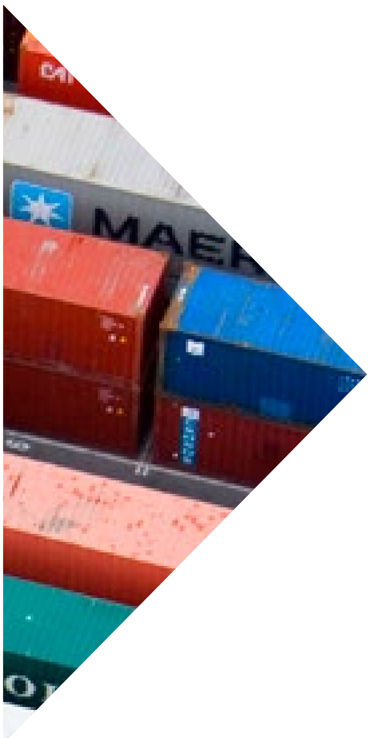
Finally, a consideration of the role of funders in the class action landscape would not be complete without mention of the way in which the commercial imperatives of third-party funders have pushed the boundaries of what is permissible under the class action regimes with a view to making class actions better suit their entrepreneurial business models. The most obvious example of this is the way in which they have changed the essential nature of many class actions from opt-out to opt-in cases by only funding claims on behalf of persons who have entered into funding agreements, which has led to closed-classes and the competing claims phenomena. More recently, funders have sought to further cement their entrenchment in class action proceedings by asking the courts to make orders that would entitle them to receive a funding commission from all group members who participate in a settlement or judgment, including those who have not signed a funding agreement. This so-called common-fund approach is discussed further below.

That said, in circumstances in which the majority of class actions are not third-party funded, we consider that the number of additional law firms looking to commence class actions may well be a more significant contributor to class action risk (at least for the moment). This is despite the fact that, unlike third party funders, the law does not currently allow lawyers to be remunerated by reference to a share of the proceeds of litigation – which, generally speaking, is considered to be a more lucrative approach than remuneration based on the value of legal work done.

Potential agents for change

A defining feature of the class actions landscape is that it is constantly evolving, often in response to attempts by class action promoters to push the boundaries of what is permissible under the class action regimes. There are a number of potential changes on the horizon that have the potential to materially affect the class actions landscape (and therefore class action risk) in the short to medium term, including the following.

- **Common fund orders – a potential game changer:** As mentioned above, third party funders are seeking to fundamentally change the class actions landscape by seeking orders from the courts that would see them receive a commission from the total amount recovered in a class action, and not just from the group members who have signed funding agreements. If permitted, this would avoid the need for funders to book-build before commencing a class action and significantly increase the amount required to settle class actions (as the funders would require a larger payment). The legality of this development was rejected by the Federal Court in 2015, but is currently before the Full Federal Court (sitting as a court of first instance) in the shareholder class action against QBE. If the practice is accepted by the courts, it will make funding class actions a more attractive proposition for local and offshore funders. The ability to do away with the book-build phase is also likely to result in a race to be first to file. The possibility that funders may one day succeed in this endeavor is arguably the most significant game-changer in the class action risk equation since the High Court gave the green light to third party funding in 2006.



- **Competing class actions:** As mentioned above, competing class actions is the term often ascribed to multiple class actions in relation to the same conduct brought by different law firms. In some cases, there is an overlap in group members and in others the classes are defined in a way that avoids overlap – where there is an overlap, class members can be asked to choose which case they want to be part of. The practical challenges and potential additional burden on litigants and the courts created by competing class actions has been a cause for concern for some time. This issue is most frequently addressed by arranging for the cases to be managed and heard together rather than, for example, staying one case and allowing the other to proceed. While resulting in many synergies, this approach often still requires a defendant and the court to deal with separate pleadings and evidence and, as such, significantly increases the costs compared to dealing with a single claim. Some class action promoters suggest that the problem can be avoided by increasing the incentive to bring open class claims by allowing common fund orders. Leaving aside the very significant question as to the legality of such orders, this is unlikely to solve the problem in this era of entrepreneurialism as recent experience suggests that the courts will not strike-out a second claim simply because it was filed after the first. The issue is likely to remain a hot topic – it is, however, unlikely that there will be any particularly radical solutions implemented in the short to medium term. In that regard we note that the Federal Court has not sought to address competing class actions in its proposed new class actions practice note which is focused on facilitating increased case management to, among other things, reduce inefficiencies and unnecessary costs.
- **The viability of shareholder class actions:** The question of whether causation in shareholder claims can be established through market-based causation has significant implications for the continuing viability of shareholder class actions. Indeed, if it is ultimately decided that market-based causation is not available, it may well signal the end of shareholder class actions as we currently know them. After more than a decade of uncertainty, in April 2016, the Supreme Court of NSW allowed causation to be established through market-based causation in a shareholder claim against HIH Insurance. This was a significant decision on an issue that has dogged shareholder class actions for more than a decade. It is, however, generally accepted that the question will not be finally resolved until it is considered by the High Court. As the HIH decision was not appealed, the next potential opportunity for a decision that may find its way to appellate courts is the shareholder class action against Allco Finance, which is scheduled for trial in October 2016.

- **The end of penalties class actions?:** The law of penalties has been in a state of flux since the status quo was challenged in the bank fees class actions in 2010. This has led to at least eleven class actions being filed, at least five others being launched and speculation in respect of many others. More than six years and two High Court appeals later, it seems likely that this hive of activity will fall away following the High Court's decision in late July 2016 that ANZ's late payment fees are not penal because they are not out of all proportion when compared to the legitimate interests the bank is entitled to protect. This decision was based on a finding that, in considering whether a fee is out of all proportion, it is appropriate to take into account the broader commercial and financial interests of the imposing party and not only the amount that could be recovered in a claim for breach of contract. Although it is too early to be sure, it seems likely that the weight of this decision will bring an end to the penalties class action bubble.
- **Contingency fees:** In December 2014, the Productivity Commission recommended the removal of the general prohibition on the charging of contingency fees in civil matters by the legal profession. It is, however, by no means certain that the prohibition will be lifted. The legal profession is divided and the Law Council of Australia does not favour their introduction. It is difficult to predict what effect lifting the ban (if it were to happen) might have on the class action landscape. As mentioned above, despite the prevalence of third party funding, the majority of class actions are run by lawyers on a no win-no fee basis. The one certainty is that providing greater incentives for lawyers to fund class actions will not reduce class action risk. Indeed, the opportunity to be remunerated by reference to a percentage of the outcome is likely to make class actions an even more attractive proposition for entrepreneurial plaintiff lawyers and will most likely result in even more firms looking to get a slice of the action. Moreover, in a similar way to common fund orders, the availability of contingency fees may well encourage a race to be first to file.
- **In pursuit of finality:** One of the objectives of the class action regime is to provide a mechanism for the final resolution of multiple claims. However, the extent to which resolution of a class action, by settlement or judgment, finally resolves all potential claims arising from the underlying facts or circumstances – or leaves the door open for individual claims to be pursued – has proved to be a contentious issue. The Victorian Supreme Court, when approving the settlement of the Great Southern class actions, held that by not opting out group members agreed to be bound by the outcome of the class action and were precluded from raising further individual claims in the future. However, a different decision was reached by the Federal Court and, most recently, the Victorian Court of Appeal in the particular circumstances of the Wilmott Forests and Timbercorp class actions respectively. The issue is now to be considered by the High Court in the context of the Timbercorp proceedings. This decision has important potential implications for the extent to which, and the circumstances in which, the class action regime may achieve finality and certainty for the parties.
- **New class action regime in Queensland:** In early August 2016, the Queensland Government announced that it will introduce legislation to allow class actions to be brought in the Supreme Court of Queensland. This is a direct response to a number of major Queensland based cases being commenced in the Supreme Courts of NSW and Victoria because of the unavailability of a local regime for negligence and breach of contract claims (which cannot be brought in the Federal Court, unless accompanied by a cause of action that attracts federal jurisdiction). The absence of a local regime has not stopped national firms filing major class actions in other jurisdictions, but it remains to be seen whether a local regime would encourage the bringing of smaller class actions by local firms.
- **Class actions in WA?:** In October 2015, the Law Reform Commission of Western Australia recommended that a class action regime similar to the Federal Court regime be introduced in WA. The WA Government has given in principle agreement to this recommendation and the Attorney General has said a proposal for legislative change will be developed. A timeframe has not been announced.

Allens > < Linklaters

A framework for considering and assessing class action risk

Having regard to the trends identified in this report and our experience, we recommend that class action risk be considered through the following lens:

- Class action risk has increased significantly over the course of the past decade – more claims are being filed and more law firms and funders are promoting claims.
- However, as can be seen from the analysis in this report, a proper assessment of class action risk requires looking behind the headlines and raw data. In our view, when considered in that context, the trend is not of epidemic or crisis proportions. That, of course, does not detract from the fact that major class actions can be a very significant drain on financial and management resources, and potentially damaging from a reputational perspective, when they arise.
- If a class action is commenced against your company, you are likely to face a period of difficult and sustained litigation (irrespective of your assessment of the merits). The class action may raise complex legal and strategic issues, be a significant drain on financial and management resources, and potentially damaging from a reputational perspective. The mere threat or launch of a class action can also have similar consequences.
- It is important to resist knee-jerk or otherwise dismissive reactions to the threat of a class action and instead to engage in an objective assessment of the risks from day one. To do otherwise puts you at a strategic disadvantage and is akin to burying your head in the sand.
- As a preventative measure, it is important to be conscious of the types of conduct that may give rise to class action risk in your business and, consistent with good risk management practice, to ensure that appropriate systems are in place to minimise the prospects of that conduct occurring. It is also prudent to have plans in place so that, in the event that something goes awry, the response can be measured and based on an objective assessment of the situation.
- Class actions are a specialised form of litigation. Entrusting your company's response (including the associated crisis management) to lawyers who are not class action experts involves unnecessary risk and puts the company at a significant strategic disadvantage. This is even more so if the lawyers bringing the claim are not experienced class action practitioners.

Scope of our research

Our research is based on publicly available information in relation to class action filings between 2005 and June 2016 in the Federal Court of Australia, and Supreme Courts of Victoria and New South Wales. It is the result of extensive searches of publicly available sources, including interlocutory and final judgments, the Federal Court's online search facility, class action publications, press reports and the websites of courts, law firms and litigation funders (and, of course, our own knowledge).

> Contacts

Jenny Campbell
Partner
T +61 2 9230 4868
M +61 425 265 415
Jenny.Campbell@allens.com.au

Ross Drinnan
Partner
T +61 2 9230 4931
M +61 410 564 931
Ross.Drinnan@allens.com.au

Belinda Thompson
Partner
T +61 3 9613 8667
M +61 403 346 405
Belinda.Thompson@allens.com.au

Duncan Travis
Partner
T +61 3 9613 8175
M +61 405 679 708
Duncan.Travis@allens.com.au

Peter O'Donahoo
Partner
T +61 3 9613 8742
M +61 411 596 178
Peter.O'Donahoo@allens.com.au

Michael Ilott
Partner
T +61 7 3334 3234
M +61 414 527 129
Michael.Ilott@allens.com.au

www.allens.com.au