How did we get here?
The history and development of securities class actions in Australia.
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Introduction from Wotton + Kearney and XL Catlin

Welcome to the XL Catlin / Wotton + Kearney whitepaper series on securities class actions and their impact on the Australian Directors’ & Officers’ Liability (D&O) insurance market. //

There is no doubt that in recent years claims relating to securities class actions have had an adverse impact on the profitability and therefore the sustainability of the D&O class in Australia. As the whitepapers will demonstrate:

• Such claims are the most significant cause of losses in the Australian D&O market with total incurred claims exceeding all other types of claims put together.
• The frequency of securities class actions in Australia, and therefore, related D&O claims, is increasing.
• Underwriting results in the D&O class are unlikely to improve without substantive changes to underwriting strategy and practice.

The objective of this series of whitepapers is to assist in establishing a foundation for a market-wide discussion on how a sustainable future for the D&O class in Australia can be achieved.

This first paper will summarise the history and state-of-play of securities class actions in Australia. While there is significant academic and legal literature on securities class actions, there is little material that provides an overview of the legal environment in a clear and concise manner which is readily accessible to underwriters, brokers, claims handlers and their clients. The first whitepaper in this series endeavours to fill this gap.

A second paper, to be released in a few months’ time, will explain in some detail the impact of class action claims on the D&O insurance market.

The third and final paper will canvass a range of potential strategies to restore underwriting profitability and longer term sustainability to this important class of insurance.

XL Catlin and Wotton + Kearney would welcome any constructive feedback to this whitepaper series and look forward to the ongoing discussion about the future of the D&O market.

What is a securities class action?

A securities class action (also referred to as a shareholder class action) is brought by a plaintiff law firm on behalf of a group of shareholders where the shareholders have suffered a financial loss as a result of a company’s alleged failure to disclose material facts to the share market.

The cost of the litigation is often paid for by a litigation funder who takes the risk of losing the case and paying the costs of the plaintiff law firm as well as adverse costs: the costs of losing, which, in the Australian jurisdiction, also include the legal costs incurred by the winning party. In return, the litigation funder will typically receive around 35% of any settlement or award paid to the shareholders.

Are class actions a new type of litigation?

Securities class actions are a relatively new and rapidly evolving form of litigation.

While class actions were first allowed in Australia by the Federal Court in 1992, it was not until 2003 that the first decision was handed down in a securities class action case, and so this form of litigation is only 13 years old.

In addition to the introduction of class actions in the Federal Court, class action legislation has also been introduced in the Victorian Supreme Court, the New South Wales Supreme Court and most recently the Queensland Supreme Court.

// The GIO class action which settled in 2003 was the first successful securities class action in Australia. Over 20,000 shareholders participated in the class action which settled for AUD 97 million, plus a further AUD 15 million in costs. //
What is required to bring a class action?

To bring a class action all that is required is that:
• 7 or more people have a claim against the same company;
• the claims are in respect of, or arise out of the same, similar or related circumstances; and
• the claims give rise to substantial common issues of law or fact.

To date, there have been few successful objections to the formation of a class action. The most notable being *Meaden v Bell Potter Securities Ltd (No. 6) [2013] FCA 1176*.

What is the purpose of a class action?

Class actions were designed to provide access to justice by allowing one claim on behalf of all shareholders, rather than requiring each shareholder to sue in separate proceedings. In 1998, the Australian Law Reform Commission report recommended the introduction of class action procedures to:
• reduce the cost of court proceedings for individuals;
• enhance access by individuals to legal remedies;
• promote efficiency in the use of court resources;
• ensure consistency in the determination of common issues; and
• make the law more enforceable and effective.

In practice, without class action laws, many of the breaches alleged in class actions would not be litigated as the cost for a single shareholder to litigate would likely be greatly outweighed by any settlement they may receive. In the GIO securities class action (commenced in 1999 and settled for AUD 97 million in 2003 involved 22,501 shareholders, with the average shareholder receiving less than AUD 4,000.¹

What other types of class actions are there?

Securities class actions are the most widely discussed form of class actions in the Australian insurance industry and mainly focused on the Australian D&O market. However, only about one third of class actions arise from securities.

Some of the largest class actions outside of securities class actions include:
• **SP AusNet / Utility Services Group:** (Black Saturday bushfires class actions): settled in 2014 for AUD 500 million.
• **Banks:**
  there have been 10 class actions against Australian banks, including Australia & New Zealand Banking Group (ANZ), Westpac Banking Corporation (Westpac), National Australia Bank (NAB), and The Commonwealth Bank of Australia (CBA), for AUD 400 million in bank fees charged to customers. These cases are still ongoing. However, in July 2016 the class action against ANZ was dismissed and until this decision is finalized, all other bank fees class actions are on hold.
• **Volkswagen, Audi and Skoda class actions:**
  the first class action proceedings in Australia against international parent companies (two filed by Bannister Law, one against Volkswagen Australia and one against Audi Australia). There have been some estimates that the class action against Volkswagen Australia could recoup as much AUD 5 billion.

Another trend to emerge in 2016 is that of alleged worker exploitation class actions. One such class action has commenced against Appco alleging sham contracting and the related underpayment of its employees. Other companies facing allegations of underpayment of workers and possible class actions in Australia include 7-Eleven, Deliveroo, Foodora and Caltex.

¹ https://www.bigclassaction.com/settlement/gio.php
Types of class actions from June 2014 to 2016

- 31% Securities
- 18% Financial products/investments
- 18% Natural disaster
- 6% Public interest & human rights
- 21% Consumer claims
- 6% Other

In particular, the Australian insurance industry now faces class actions affecting a diverse range of insurance policies, including product liability, public liability, professional indemnity and environmental liability, as well as directors’ & officers’ insurance.

What is typically alleged in a securities class action?

Misleading and deceptive conduct claims continue to be the primary basis for securities class actions. It is only necessary to prove that the company misled the market. It is irrelevant whether or not the company intended to do so or was negligent. Similar allegations can be levelled against directors for representations they made or if they were knowingly involved in the company’s conduct.

Securities class actions also typically involve allegations that the company has breached its duties of continuous disclosure by incorrectly disclosing or failing to disclose a material fact. These failures are often due to incorrect earnings guidance, misstating the financial position of the company, or misstatements in a prospectus-type document.

These allegations are exceedingly difficult for a company to successfully defend.

In May 2015, dairy processing company Murray Goulburn made a partial listing on the ASX to raise AUD 500 million. Just a year later however, concerns regarding the “over inflated” revenue and profits from the sale of milk products, which was projected in the lead-up to the capital raising, came to light and a class action has been commenced by Mark Elliot on behalf of unitholders. Slater & Gordon has also announced it is investigating an action.

A company’s continuous disclosure obligations under ASX Listing Rule 3.1 require immediate disclosure of market sensitive information. Unlike criminal matters, the breach and the right to compensation does not require any intention to deliberately withhold disclosure and can be due to an honest mistake.

In the ASX Guidance Note 8 entitled “Continuous Disclosure: Listing Rules 3.1-3.1B” regarding proposed draft amendments to Listing Rule 3.1, the ASX proposed that “immediately” means “prompt” rather than “instantaneous”.

However, in the Leighton Holdings matter in 2012, the Australian Securities & Investments Commission’s (ASIC) chairman confirmed “immediately means immediately”. In this case, Leighton Holdings failed to promptly disclose to its shareholders major delays in the Brisbane Airport Link project, Victoria’s Desalination Plant, and projects it was involved in in the Middle East. The delays caused a AUD 900 million downgrade in profit, and the losses weren’t reported to the market until three weeks after the directors were first made aware. A trading halt was placed on the shares. However, once lifted, the shares dropped 12%, causing wide-spread losses. An ASIC investigation took place and Leighton was fined AUD 300,000. Leighton was also required to undertake an internal review of its disclosure procedures.

Based upon similar allegations, a securities class action was launched that settled for almost AUD 70 million.

1 Coupled with section 674 of the Corporations Act (Cth) 2001

2 Inabu Pty Ltd ACN 003 657 654 As Trustee For The Alidas Superannuation Fund v Leighton Holdings Limited ACN 004 482 982
In addition to ASX Listing Rule 3.1, securities class actions also often allege a breach of the Australian Consumer Law (previously the Trade Practices Act 1974). Like the Listing Rules, there is no need for the company to have intended to mislead or deceive for an action to succeed. All that is required is that the statement be materially incorrect or misleading.

Who is liable to pay costs in securities class actions? How are they calculated?

Over the securities class action settlements reached between 2003 and 2016, the defence costs incurred range from as low as AUD 1 million to as high as AUD 20 million, with the average coverage costs being AUD 700,000.

If a class action proceeds to a final judgment at trial, the costs are awarded against the losing party paying the successful party’s costs. Costs that were reasonably and properly incurred by a party in relation to the litigation are awarded on a ‘party-party’ basis. This generally equates to 60-70% of the actual costs incurred by the successful party in a class action.

In addition to this, the court may also award costs (i.e. an award of indemnity costs), meaning that the successful party is entitled to be awarded close to the full costs it incurred in relation to the class action.

In reality most class actions are settled with the Court approving an amount for the class members’ legal costs, and the respondents bearing their own costs.

How is causation proved in a securities class action?

Causation has been a hotly debated issue for securities class actions over the last few years. In June 2014, the United States Supreme Court in the case of Halliburton Co. v. Erica P. John Fund, Inc. decided that shareholders involved in a securities class action do not need to prove that they relied on a company’s misrepresentations when investing in shares. Rather, they need simply to establish ‘fraud on the market’. The ‘fraud on the market’ theory assumes that the price represents all publicly available information, including any erroneous statements or misrepresentations made by a company.
Thus, any shareholder who subsequently buys or sells shares will have relied on the market-determined share price, thereby implicitly relying on the misrepresentations made by the company.

Only 2 years after *Halliburton Co. v. Erica P. John Fund, Inc.*[^5], the New South Wales Supreme Court has held that shareholders can prove ‘market-based causation’ in *Re HIH Insurance Limited (In liquidation)*[^6]. This is similar, but not identical, to the ‘fraud on the market’ theory. The primary difference is the acceptance that other external factors, such as the global financial crisis of 2008, may affect the price and need to be accounted for in determining causation. This decision has important implications for Australian companies, given that the onus to prove causation or reliance upon the misstatement is all but assumed by ‘market-based causation’, and therefore there is little need for the plaintiff to prove such. While the New South Wales Supreme Court’s ruling has not established a nationwide authority, it does provide guidance to other jurisdictions considering market-based causation, and it seems reasonable to expect that the Federal Court and the Supreme Court of Victoria would follow a similar approach.

### Jurisdiction comparison

<table>
<thead>
<tr>
<th>Class action</th>
<th>Australia</th>
<th>US</th>
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<th>UK</th>
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<tr>
<td>Contingency fees</td>
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<td>permitted</td>
<td>permitted</td>
<td>permitted in non-contentious litigation</td>
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<td>Party costs</td>
<td>“loser-pays” rule</td>
<td>each side bears its own costs</td>
<td>“loser-pays” rule</td>
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<td>Opt-out eligibility</td>
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<td>opt-out actions allowed</td>
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<td>Opt-in procedure</td>
<td>closed classes only</td>
<td>no opt-in classes</td>
<td>opt-in mechanism in place</td>
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<td>Causation</td>
<td>market-based</td>
<td>“fraud on the market”</td>
<td>rejected “fraud on the market”</td>
<td>must prove direct reliance</td>
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<td>Civil matter</td>
<td>single judge</td>
<td>right to jury trial</td>
<td>jury trial may be allowed (no right)</td>
<td>no jury trials</td>
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<td>Punitive damages</td>
<td>no</td>
<td>yes</td>
<td>yes</td>
<td>no</td>
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<td>Common issues</td>
<td>one common issue of law/fact</td>
<td>common issues outweigh individual issues</td>
<td>weigh common issues in relation to individual issues (no predominance)</td>
<td>one common issue of law/fact</td>
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<td>Class certification</td>
<td>onus is on defendant to prove class is not certified</td>
<td>onus is on lead plaintiff to certify class in court</td>
<td>onus is on lead plaintiff to certify class in court</td>
<td>onus is on lead plaintiff to certify class in court</td>
</tr>
</tbody>
</table>

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[^5]: 563 US 804 (2011)
[^6]: [2016] NSWSC 482
How does the Australian securities class action environment compare to overseas?

While there are not as many securities class actions as there are in the United States, Australia has developed into arguably the most liberal class action regime in the world.

Unlike in the US, there is no requirement for certification or that common issues predominate over individual cases. Another important characteristic of the Australian class action regime is that there need be only one substantial common issue of law or fact to form the class. As a comparison, in the US and the UK, the common issues between the individual Class members must prevail over individual issues for the class to be formed.

We have seen the growth of new class action jurisdictions outside of the US and Australia after the effect of the US Supreme Court’s 2012 decision in National Australia Bank v Morrison. The decision to limit the extraterritorial application of US securities laws caused plaintiff lawyers to seek new securities class action jurisdictions such as the UK.

Class actions are a reasonably new phenomenon in the UK. The advent of class actions is supported by new entrants to the UK litigation funding market including Bentham Europe Limited and Balance Legal Capital, as well as Therium Capital Management Limited after a capital raising in May 2015. Interestingly, it should be noted that Bentham Europe Limited, established in 2014, began as a joint venture between the Australian company IMF Bentham and subsidiary entities of funds managed by Elliott Management Corporation.

Additionally, class action firms in Australia have grown their presence in the UK.

// In July 2016, litigation funder IMF Bentham’s share of Bentham Europe Ltd was sold. IMF Bentham has been precluded from funding matters in Europe for 12 months. //

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The prevalence of securities class actions

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<th>Australia</th>
<th>US</th>
<th>Canada</th>
<th>UK</th>
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<tr>
<td>Total number of securities class actions (2000-2016)</td>
<td>4,372*</td>
<td>48</td>
<td>127</td>
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<td>Approximate average number of securities class actions per annum</td>
<td>257</td>
<td>3</td>
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<td>Total new securities class actions filed in 2016</td>
<td>300</td>
<td>12</td>
<td>9</td>
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<td>Listed domestic companies (2015)</td>
<td>4,381</td>
<td>1,989</td>
<td>3,799</td>
<td>1,858</td>
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<td>Securities class actions filed per (listed domestic) company per 1000</td>
<td>53.41</td>
<td>3.02</td>
<td>1.05</td>
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*Including UP/PO laddering cases from 2000–2016
### New securities class actions filed

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### Securities class action settlements 2003 to 2016

**Settlement value (millions of $ AUD)**

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<thead>
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<th>Name</th>
<th>Year</th>
<th>Settlement Value</th>
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<td>GIO</td>
<td>112</td>
<td>$112</td>
</tr>
<tr>
<td>Downer Edi</td>
<td>30</td>
<td>$30</td>
</tr>
<tr>
<td>Aristocrat Leisure Ltd</td>
<td>144.5</td>
<td>$144.5</td>
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<tr>
<td>Sons of Gwalia</td>
<td>70</td>
<td>$70</td>
</tr>
<tr>
<td>Brookfield Multiplex</td>
<td>110</td>
<td>$110</td>
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<tr>
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<td>$39.5</td>
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<tr>
<td>OTR Minerals Ltd (x2)</td>
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<td>$60</td>
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<tr>
<td>Centro Properties Ltd</td>
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<tr>
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<td>Transfield Industries Group</td>
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<td>Nufarm Ltd</td>
<td>35</td>
<td>$35</td>
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<tr>
<td>Golden 11</td>
<td>75</td>
<td>$75</td>
</tr>
<tr>
<td>Pacific Intertubes Group</td>
<td>69.45</td>
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<td>Qne</td>
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<tr>
<td>Leighton Holdings Ltd</td>
<td>36</td>
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</tr>
<tr>
<td>River City Motorway Group</td>
<td>45</td>
<td>$45</td>
</tr>
<tr>
<td>Newcrest</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Billabong</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Parties to a securities class action

There are a number of parties to a securities class action. In many cases, a precursor to a securities class action is an investigation by ASIC into the company and its directors’ & officers’ to determine if there has been a breach of continuous disclosure. The securities class action is then commenced by the plaintiff law firm representing the representative plaintiff on behalf of all class members. The legal and other costs to launch and run the securities class action are paid for by the litigation funders. The securities class action is brought against the defendants, who are represented by the defence law firm, and likely paid for by their insurer. The insurer will likely appoint coverage counsel to assist them in the oversight of the securities class action.

Litigation funders

Class action proceedings are exceedingly expensive, and can cost each party upward of AUD 10 million. This is due to the complexity of the issues that are being litigated, the number of plaintiffs (and potentially defendants), and the fact that this is still a legal area in development. While shareholder class actions are designed to level the playing field between individual investors and large corporations, the process of consolidating several claims into one is inherently very costly and it is difficult to fund a securities class action by having each shareholder agree to pay a portion of the plaintiff firm’s costs and accept any adverse awards that would be made if the action were to fail. This has led to the development of litigation funders in Australia.

A litigation funder is an institutional financier who pays the legal fees and other costs of the litigation, including any adverse award for costs. In return for this, should the class action be successful, the litigation funder will take a percentage of the settlement sum as a fee. Litigation finance companies will often receive from 25% to 40% of the settlement sum, though in some cases, funders have sought up to 75% of the sum.

In recent years, virtually all securities class action proceedings have been funded by litigation funders. While proponents argue that this has increased access to justice for individual plaintiffs who have suffered losses, the commercial implication is that it is seldom that a shareholder seeks out the plaintiff law firm and litigation funder, but rather it is the plaintiff law firm and litigation funders that advertise for plaintiffs who may have been affected. Individual retail shareholders don’t tend to receive significant proceeds in such a proceeding.

IMF Bentham is Australia’s largest litigation funder with approximately 69% of the Australian litigation funding market. With IMF’s success in Australia since their ASX listing in 2001, they have expanded into Europe, the US and Asia.

Following their success, we have seen an explosion of litigation funders in Australia since 2009. Some plaintiff law firms are even looking to set up their own litigation funding arms, though the courts have resisted so far. To date, there are 17 commercial litigation funders that have funded or propose to fund class actions in Australia.

When a plaintiff law firm doesn’t use litigation funders, the outcome tends not to be successful. Plaintiff law firm Macpherson + Kelley represented members in the Wilmot, Great Southern and Timbercorp Class Actions, where the burden of funding was placed upon the class members. In Timbercorp, which was dismissed in 2011, the class members did not only need to honor their original loan obligations to Timbercorp, but they also had to pay their own costs incurred as a result of the litigation. This was largely the result of the plaintiff’s inability to prove that they relied on Timbercorp’s product disclosure statements, which were allegedly misleading.

This increase from a single dominant litigation funder to numerous funders has created competition, with some litigation funders seeking to be the first to file a class action. This has created a number of concurrent class actions funded by competing funders. As an example, in June 2012 the Federal Court approved a AUD 200 million settlement for the Centro class action, three-quarters of that sum (AUD 150 million) was allotted to the class actions funded by IMF Bentham and run by the plaintiff law firm, Maurice Blackburn. The other quarter (AUD 50 million), was allocated to the concurrent class actions run by competing plaintiff law firm, Slater & Gordon, whose funders were Comprehensive Legal Funding LLC.

// There are currently 17 commercial litigation funders in the Australian market, compared to 7 in 2012. //
Australia’s litigation funders

<table>
<thead>
<tr>
<th>Litigation Funder</th>
<th>Listed?</th>
<th>Location of incorporation</th>
<th>First funding involvement</th>
</tr>
</thead>
<tbody>
<tr>
<td>IMF Bentham Ltd</td>
<td>Yes</td>
<td>Australia</td>
<td>2001</td>
</tr>
<tr>
<td>Hillcrest Litigation Services Ltd</td>
<td>No</td>
<td>Australia</td>
<td>2009</td>
</tr>
<tr>
<td>Harbour Litigation Funding Ltd</td>
<td>No</td>
<td>UK</td>
<td>2009</td>
</tr>
<tr>
<td>Litigation Lending Services Ltd</td>
<td>No</td>
<td>Australia</td>
<td>2009</td>
</tr>
<tr>
<td>Comprehensive Legal Funding LLC</td>
<td>No</td>
<td>USA</td>
<td>2010</td>
</tr>
<tr>
<td>Omni Bridgeway</td>
<td>No</td>
<td>Netherlands</td>
<td>2010</td>
</tr>
<tr>
<td>Argentum Investment Management Ltd</td>
<td>No</td>
<td>UK</td>
<td>2012</td>
</tr>
<tr>
<td>Bookarelli Pty Ltd</td>
<td>No</td>
<td>Australia</td>
<td>2012</td>
</tr>
<tr>
<td>BSL Litigation Partners Ltd</td>
<td>No</td>
<td>Australia</td>
<td>2013</td>
</tr>
<tr>
<td>Claims Funding Australia Pty Ltd</td>
<td>No</td>
<td>Australia</td>
<td>2013</td>
</tr>
<tr>
<td>International Litigation Funding Partners Pte Ltd</td>
<td>No</td>
<td>Singapore</td>
<td>2013</td>
</tr>
<tr>
<td>LCM Litigation Fund Pty Ltd</td>
<td>No</td>
<td>Australia</td>
<td>2013</td>
</tr>
<tr>
<td>Legal Justice Pty Ltd</td>
<td>No</td>
<td>Australia</td>
<td>2013</td>
</tr>
<tr>
<td>Litman Holdings Pty Ltd</td>
<td>No</td>
<td>Australia</td>
<td>2013</td>
</tr>
<tr>
<td>JustKapital Litigation Partners Ltd</td>
<td>Yes</td>
<td>Australia</td>
<td>2014</td>
</tr>
<tr>
<td>CVC Litigation Funding Pty Ltd</td>
<td>No</td>
<td>Australia</td>
<td>Prospecting</td>
</tr>
<tr>
<td>International Justice Fund Ltd</td>
<td>No</td>
<td>Australia</td>
<td>Prospecting</td>
</tr>
</tbody>
</table>

Plaintiff law firms

A growing number of plaintiff law firms have emerged in response to the favourable climate of instituting proceedings of this nature. The predominant plaintiff law firms that conduct securities class actions are Maurice Blackburn and Slater & Gordon.

Maurice Blackburn is currently involved in 26 class actions, a quarter of which are securities class actions. They conducted the first cases of this kind in Australia and have secured some of the highest securities class action settlements in Australian legal history, including settlements of AUD 69.45 million, AUD 97 million and AUD 150 million, in the Leighton, GIO and Centro securities class actions respectively. Slater & Gordon are a major competitor taking on a large number of claims, including 23 Class Actions, of which 4 are securities class actions.

A more recent entrant into the Australian market is ACA Lawyers who have been involved in a number of securities class actions including the second Oz Minerals case and Padbury Mining. Shine Lawyers have also expanded their involvement in class actions to include securities class actions with their recent participation in the Wickham...
Securities Sandhurst class action. The attractiveness of Australia’s class action environment has also seen US firms instigate proceedings including Squire Patton Boggs and Quinn Emanuel, either independently or in association with local firms.

**Representative plaintiffs**

Class actions are typically brought by one or just a few shareholders on behalf of a class of members. The individual commencing the proceedings is known as the representative plaintiff. The representative plaintiff will typically be a single shareholder who has suffered a loss as a result of a company’s conduct.

While there are no key requirements of a representative plaintiff beyond being part of the class, there have been two notable issues raised with respect to selecting an appropriate representative plaintiff.

The first was in the class action against Timbercorp, where the representative plaintiff was shown to not have relied upon the misstatements that were alleged as part of the class action. As a result, given there was no reliance by the representative plaintiff that led to the loss, the defendant won the matter.

Melbourne City Investments was the representative plaintiff in a securities class action commenced against Treasury Wines and Leighton Holdings. Mark Elliott was the sole director and shareholder of Melbourne City Investments, as well as the plaintiff lawyer in the two actions. The court determined that Mr. Elliott could not be both the plaintiff lawyer and the representative plaintiff as he would face a conflict of interest.

In another example, while it was not a securities class action per se, the Bell Potter securities class action was also dismissed as it was in the interests of justice to do so. In this particular case, the court determined that the representative plaintiff was not suitable as she would not determine any matters of sufficient significance that would be representative of the other class members.

**Class members**

Class members are represented by the representative plaintiff.

There are two types of classes in a class action: ‘open classes’ and ‘closed classes’.

An ‘open class’, also referred to as an ‘opt-out class’, is a class that represents all members who meet a definition such as “all shareholders of XYZ who bought shares between 1 January 2016 and 1 April 2016”. The members that meet this criterion may elect to opt out of the class action. Plaintiff law firms continue to criticize open class actions, on the basis that it allows those that are members of the class to benefit from the proceeds of the action, but have not entered into any funding agreement. At present there is no basis for the court to prefer an ‘opt-in’ class action over an ‘opt-out’ class action or to require all members, including those who have not signed a funding agreement, to pay a funding commission. Third party funders in response, tend to focus on opt-in class actions which are brought solely by members who have entered into funding agreements.

In contrast, a closed class is a class whose members are determined at the filing of the action. This is generally on behalf of those members that are identified as having bought shares during the relevant period, retained the plaintiff lawyers, and possibly also entered into a specified litigation funding agreement.

Opt-in classes must be formed as a closed class where the members have opted-in by retaining the plaintiff lawyers prior to filing the action. However, an opt-in class may not be structured where the action is filed, but that the members must enter into an agreement to join the action. There have been attempts to have open classes defined only by those who have entered into an agreement with the plaintiff lawyer and/or litigation funder, but this has been determined by the Court as a characteristic of an opt-in class and has not been allowed.
Benefits of an open class to an insurer

<table>
<thead>
<tr>
<th>Pros</th>
<th>Cons</th>
</tr>
</thead>
<tbody>
<tr>
<td>All members who fall within the defined class are automatically included in the class action on the filing of the claim, reducing the likelihood of subsequent litigation by other shareholders.</td>
<td>This method means that there are potentially more claimants participating in the proceedings, and subsequently higher settlement sums.</td>
</tr>
<tr>
<td>All members are notified of the action and explained their right to opt out and the date by which they must do so.</td>
<td>If a member of the class does choose to opt out, they have the option of bringing their own proceeding against the defendant company in the future.</td>
</tr>
</tbody>
</table>

This method aims at limiting the amount of actions filed against an individual company, initially including all members and requiring them to opt-out.

Defendants

The typical defendant(s) for a securities class action are listed on the ASX, with a market capitalisation of over AUD 100 million\(^\text{13}\). In addition, albeit less common, directors and officers as well as professional advisors may be named as parties to the proceeding. In Australia it is up to the defendant(s) to challenge a class action for the purpose of having it discontinued on the grounds that the threshold requirements under the relevant legislation of the chosen jurisdiction are not met. Given how low the threshold is to form a class action, it is often difficult to get the action to be discontinued.

Class action proceedings can often involve multiple defendants. While Section 33C(1)(a) of the Federal Court of Australia Act 1976 (Cth) requires “claims against the same person”, The Full Court of the Federal Court has interpreted this as meaning that the applicant (representative plaintiff) needed to have a claim against all defendants but it was not necessary for every group member to have claims against all defendants\(^\text{14}\).

Defence law firms

Given the size and nature of the defendant company, it will typically have in-house counsel and law firms it regularly engages when faced with the possibility of litigation. However, defending a securities class action is a specialised field, and there is a need to engage law firms with significant experience in these actions. Given that there tend to be multiple defendants, multiple firms can be engaged. While these law firms are retained by the defendant, the firm needs to have a strong relationship with the insurer and the other parties in the securities class action to achieve the most favourable outcome. While an aggressive and hostile approach to litigation looks good on television, it often leads to protracted, expensive and bitter litigation.

A firm with expertise in securities class actions will have significant hands-on experience defending claims. The successful management of defended claims rests on the fundamental principles of:

- devising swift and efficient claims investigation and evidentiary strategies;
- building rapport with opponents to facilitate early claim resolution;
- navigating the various jurisdictions (including Federal, NSW, VIC and QLD) across Australia to ensure the proactive progression of litigated claims towards pre-trial settlement in class actions;
- crafting settlement strategies involving the use of alternative dispute resolution (ADR) mechanisms;
- identifying recovery opportunities early; and managing the interests of all stakeholders.

As an example, Wotton + Kearney have built a successful practice in representing the company and directors in securities class actions and other securities investigations and litigation. Major securities class actions that Wotton + Kearney have been involved in include Forge, QRX Pharma and Tamaya.

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\(^{13}\) For example, the previous CEO of IMF Bentham, John Walker, has provided guidance at various speaking events where he has suggested that they are seeking a AUD 100 million market capitalisation of companies in which prospective class actions may be filed against. \(^{14}\) Bray v F Hoffman-La Roche Ltd [2003] FCAFC 153; [2003] 130 FCR 317, [243]-[248] Finkelstein J (with whom Carr J agreed) and confirmed in 2014 in Cash Converters International Limited v Gray [2014] FCAFC 111.
Coverage or monitoring counsel

Coverage or monitoring counsel are lawyers who are retained and paid for by the insurer to assist them in maintaining an overview of the claim.

While it is clear that defence counsel have a key role to play in defending securities class actions and trying to achieve the best possible outcome, the Insurer and coverage counsel’s equally important role is less obvious.

By working with the Insurer and defence counsel, effective coverage counsel can orchestrate significant savings for insurers and reduce any out-of-pocket expenses that may be payable by the Insured, so that the policy proceeds go further by:

• contributing to settlement and strategy discussions and ensuring that the Insurer is fully informed and therefore able to make timely and informed decisions on whether proposed settlement sums are proportionate. Otherwise, a settlement may be delayed due to defendant law firms needing to justify the reason for the settlement;
• actively engaging with the insurance market to ensure that, where appropriate, other Insurers are informed and engaged so that decisions can be made quickly should contribution to settlement be required;
• monitoring settlement and strategy developments to ensure that defence counsel are acting in the Insured’s and insurers’ best interests; and
• monitoring defence costs and ensuring that costs incurred are reasonable and not excessive.

A further consideration is the role of coverage counsel if insurers elect to appoint separate coverage counsel. The extent to which a single coverage counsel can be appointed on behalf of all Insurers is likely to dramatically impact progress, settlement and management of coverage costs.

The industry term of coverage counsel is a misnomer with respect to securities class actions. In our experience, an Insurer declining cover is very unusual. We have seen such declinatures happen rarely in circumstances whereby:

• the company knew of circumstances that might give rise to a securities claim prior to purchasing the insurance, referred to as ‘known facts or circumstances’. In many of these cases, it is the company’s earlier insurance cover that would respond;
• based on finding of fact or final adjudication, the company had engaged in knowingly fraudulent or criminal acts that caused the securities claim;
• the company has not purchased cover for the company in securities class actions; or
• the representative plaintiff falls within an excluded claimant group under a major shareholder exclusion in the policy.

Insurers

A capable D&O insurer is critical when a securities class action occurs.

While many companies and their advisors focus upon the sufficiency of the limits and the breadth of coverage, far too few companies put sufficient time into understanding the capability of their D&O insurer.

A lead D&O insurer’s experience is critical as they can:

• advise a company and its senior executives on the selection of defence lawyers and other advisers;
• ensure that defence counsel are charging more favourable rates, as often they have significant commercial leverage to obtain a significant reduction on a law firm’s standard rates;
• assist in providing strategic input into the action’s management;
• manage other Insurers in the tower of insurance, as they will respect the decision the lead Insurer makes, rather than looking to “second-guess” them; and
• consent to costs and settlements rapidly.

We would suggest that there is real benefit for a company and their insurance advisors in building a tripartite relationship with their primary D&O insurers, including both the underwriters and claims personnel. As a major global D&O insurer XL Catlin offers a combination of both onshore and international expertise in the management and settlement of securities class actions.
Australian Securities & Investment Commission (ASIC)

ASIC may investigate any allegation concerning a breach of continuous disclosure by a listed company.

In such matters, ASIC’s primary focus is the impacts this could have on the share market and to prevent similar cases occurring in the future, including taking action against the company and those individuals responsible.

It is common then that an ASIC investigation will be a precursor to a securities class action, and will often provide a blueprint to litigation funders and plaintiff law firms that are considering a securities class action. For example, in September 2014 Newcrest Mining Limited came under fire following investigations alleging Newcrest breached its continuous disclosure obligations by failing to make timely disclosures after market confidentiality was lost. In June 2014, Newcrest admitted it breached the law and paid a AUD 1.2 million settlement to ASIC. Just one month later, a securities class action was commenced on similar grounds by Slater & Gordon. This securities class action settled in February 2017 for AUD 36 million.

ASIC has wide ranging powers under the ASIC Act (2001) and the Corporations Act (2001).

Further, under section 50 of the ASIC Act (2001), ASIC can bring about civil proceedings on behalf of shareholders. However, in recent years, ASIC has preferred to defer to securities class actions rather than incur the cost and litigation risk of bringing an action under section 50. Under ASIC’s policy statement, ASIC is reluctant to undertake civil proceedings in cases where there is a plaintiff with sufficient funds to undertake the action, such as a litigation-funded securities class action.

Rather than bringing civil action, ASIC often continues to vigorously pursue criminal proceedings under Section 1317P of the Corporations Act (2001) in high profile cases.

In addition to civil and/or criminal proceedings, ASIC and the company may enter into an enforceable undertaking, meaning an agreement between ASIC and the company that the company will pay a fine, compensation, or take other steps necessary to rectify the situation, and in return ASIC will not prosecute. As part of these enforceable undertakings, the company will not generally make an admission of guilt or liability.

However, enforceable undertakings will often provide ammunition to litigation funders and plaintiff law firms to consider a securities class action, which would subsequently cost far more in litigation than any fine or other compensation.

ASIC may become involved in proceedings as a friend of the court (amicus curiae) where the issues within the proceedings raise relevant regulatory or consumer protection issues.

// In 2006, following concerns it had breached its continuous disclosure obligations, Multiplex entered into an enforceable undertaking with ASIC promising that it would compensate investors and conduct an external review of its disclosure procedures. Despite the undertaking, a class action was filed which settled in 2010 for AUD 110 million. It was estimated investors received 20 times more in the class action settlement than they would have, had they accepted the undertaking settlement offer. //

// Newcrest Mining Limited paid ASIC a fine of AUD 1.2 million, the highest corporate penalty over disclosure laws in the past decade. //

Under section 19 of the ASIC Act (2001), ASIC has broad powers to question directors and officers of companies that are under investigation, and those same directors and officers are compelled to answer these questions. Under section 25, ASIC are able to provide ‘records of interview’ to lawyers who have brought, or are in the process of bringing a securities class action concerning something which ASIC’s own examination has revealed.

Under section 19 of the ASIC Act (2001), ASIC has broad powers to question directors and officers of companies that are under investigation, and those same directors and officers are compelled to answer these questions. Under section 25, ASIC are able to provide ‘records of interview’ to lawyers who have brought, or are in the process of bringing a securities class action concerning something which ASIC’s own examination has revealed.
Regulation of litigation funding

There have been various attempts to regulate and impose oversight on litigation funders. The High Court approved the legality of litigation funders in *Campbells Cash and Carry Pty Limited v Fostif* 15, overcoming the long established rules of champerty and maintenance, which precluded a third party financing and benefitting from litigation.

There was the Full Federal Court’s decision in *Brookfield Multiplex Ltd v International Litigation Funding Partners Pte Ltd* 16 which held that litigation funders hold an Australian Financial Services License and met other requirements under the *Corporations Act* (2001). However, immediately following that judgment, ASIC provided an ongoing exemption from these requirements and subsequently the legislation was amended to exclude litigation funding agreements and similar from such arrangements.17

In addition, the High Court in *International Litigation Partners PTE Ltd v Chamelion Mining NL* 18 determined that a litigation provider may require a credit license19 and meet the regulatory requirements of the National Consumer Credit Code. Therefore, the primary regulation of litigation funding falls to the Court, who only intervened sparingly.

The Federal Court recently provided a useful example of when it will exercise control over liquidators and litigation funders in its decision in the matter of *Great Southern Limited* 20. The liquidators sought Court approval to enter into a funding agreement with a new litigation funder with respect to potential claims concerning alleged breaches of directors’ duties and a claim against the auditors of Great Southern. Money advanced under the previous funding agreement had been exhausted and the previous funder had declined to provide any further funding.

The Court was critical of the fact that the liquidators had been in office for three years and had already had the benefit of AUD 400,000 in litigation funding yet could not provide evidence regarding the prospects of success, nor evidence about the estimated value of the potential claims. The Court was therefore not prepared to approve a second litigation funding agreement which would have resulted in an estimated AUD 31 million in legal costs being incurred.

The common fund

Up until the decision of *Money Max International Pty Ltd (Trustee) v QBE Insurance Group Limited* [2016] FCAFC 148 litigation funders had only been able to derive fees from those class members who enter into funding agreements with them. As a result, the preferred model of litigation funding has been a “closed class” action where all class members sign up to funding agreements. If a funder pursued an “open class” action, the Courts would seek to address the issue by making funding equalisation orders to address the perceived inequity which arises when funded class members bear the obligation to compensate the funder, while unfunded class members do not.

The QBE decision is a potential game changer paving the way for litigation funders in open class actions to obtain fees from class members without the need to enter into funding agreements. The Court was satisfied that the interest of class members supported imposing the burden of funders’ fees equally upon all class members who stand to benefit from the proceeding, whether or not they previously entered into a funding agreement.

The check and balance on the process is that the Court will determine the reasonable rate of commission to be paid to the funder at the end of the proceeding. The Court stipulated that the fee is highly likely to be less than the 32.5% or 35% funding commission agreed under the existing funding agreement.

Whilst this was predicted to lead to an increase in open class actions, it appears that, at least to date, there has been a mixed response on the part of funders to take on the risk and uncertainty inherent in litigation funding in circumstances where the potential reward for doing so will only be determined at the end of the proceedings and in the Court’s discretion.

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Typical stages of a securities class action

- ASIC investigation
- Class action due diligence
- Funding agreement
- Class action “launched”
- Adequacy of pleading
- Request for particulars
- Insurance indemnity
- Advertise for class members
- Securities class action claim filed
- “Opt-out” notice
- Defence
- Discovery
- Trial
- Settlement
- Application for proceedings to be discontinued
- Evidence
Stages of a securities class action

When a listed company experiences a material fall in share price or makes an announcement concerning a change in projected profit or a restatement of financials, ASIC will likely enquire or investigate the circumstances surrounding the company’s change in position. This is often the starting point of a securities class action.
ASIC Investigation

ASIC will undertake a review where there has been a sudden drop in a share price linked with a “shock announcement”.

Typically after a “shock announcement” has been released, the Australian Stock Exchange (ASX) may issue a price query in the form of a set of questions. ASX queries may be non-price sensitive, meaning they are simply queries into the company’s financial background or the like.

Where initial queries and the responses to the ASX suggest that there is a need for further investigation, ASIC may then launch a more formal investigation. These investigations may lead to a prosecution, and will often provide information that can be relied upon as part of the class action due diligence.

Class action due diligence

Subsequent to a formal ASIC investigation, a plaintiff law firm or litigation funder may conduct its own investigation to assess whether there may be a profitable class action that could be commenced.

Typically this investigatory period or due diligence will last anywhere between 6 months and 3 years (including the aforementioned queries and formal investigations carried out by ASIC) and will cost the party who carries out the investigation anywhere between AUD 100,000 and AUD 500,000.

Funding agreement

Depending on who has conducted the due diligence investigation, either the litigation funder will approach the plaintiff law firm or the plaintiff law firm may approach the litigation funder for funding.

As an example, IMF Bentham would approach Maurice Blackburn with the possibility of filing a class action against a company whose share price has dropped as a result of a “shock announcement” by the company.

Class action “launched”

Class actions are often “launched” before they are filed.

// Interestingly, three ‘launched’ class actions have been settled before they were even filed. //

Launching a class action enables plaintiff law firms and litigation funders alike to gauge the interest among potential group members. It also allows litigation funders to engage in a “book building” process. When a plaintiff law firm “launches” a class action they do not need to have formed a reasonable case, or in other words, the claim does not need to have reasonable prospects of success, as must be the case when a class action claim is filed. Often adverse media attention will be attracted to a class action launch, which will allege certain misconduct on the part of the ‘would-be’ defendant company (if it were to be filed). This can often cause the company’s share price to fall.

Advertise for class members

The plaintiff law firm and/or litigation funder will advertise on their website, in widely circulated business publications and also news wire services how an individual may register to join a securities class action, subject to certain requirements. For example, a plaintiff law firm may write “If you purchased shares in X company between 20 October 2009 and 2 June 2011 you may be eligible to recover losses suffered as a result of the misconduct of the defendants”. This timeframe is known as the ‘period of claim’ or ‘class period’.

Securities class action claim filed

A representative plaintiff who represents all class members will file an application commencing a securities class action with the Court. In addition to this application the plaintiff law firm, on behalf of the representative plaintiff and the class, will prepare a statement of claim (or affidavit) supporting the filed application. The statement of claim is supporting documentation that describes the nature of the claim and the facts upon which it is based.
Given increased competition in the litigation funding market, with the number of litigation funders doubling since 2014, there is often a ‘race to file amongst funders’. This often results in ‘concurrent class actions’. For example, the class action against Vocation Ltd has three different plaintiff law firms with different litigation funders behind them, and a consolidated pleading.

In these concurrent class actions, there is often a ‘race to file’, on the premise that the first to file may have an advantage in gathering class members or being appointed as the firm in a consolidated class action. However, while the courts have broad powers of discretion to undertake case management, they have been reticent to consolidate the cases and effectively appoint one plaintiff law firm in preference of another. As an example, in the concurrent matters against Australian Executor Trustees Limited, the court elected to have the matters heard concurrently in one case21.

### Adequacy of pleading

Once the application and statement of claim have been filed for the class action, the onus is on the defendant to prove that the threshold requirements for a securities class action have not been met (i.e. a minimum of 7 class members, with similar claims towards a defendant(s), whose claims arose out of similar circumstances). This is in stark contrast to the U.S, where a court has to certify a class action (referred to as ‘class certification’).

### Request for particulars

The defendant or the Court may request for further and/or better particulars, including supporting documentation for the statement of claim filed by the representative plaintiff.

### Insurance indemnity

While the company and its directors and officers should have notified their Insurer of circumstances that may give rise to a claim earlier, it is likely that at the point the securities class action is filed the Insurer is in a position to confirm its indemnity position.

If D&O insurance has been purchased by the defendant company covering the company for securities class actions, then the insurer will confirm cover, potentially with a ‘reservation of rights’, which highlights that if information comes to light that the claim is not covered, then the Insurer has the right to withdraw.

### Filing a defence

The defendant will file a substantiative defence where the defendant will respond to the plaintiff’s filed claim. At this stage the costs incurred by the defendant party filing the substantive defence, is anywhere between AUD 250,000 and AUD 1 million.

### Discovery

During the discovery and witness evidence stage, both the plaintiff and defendant will disclose documents and answer specific requests, called interrogatories.

// Discovery may cost as little as AUD 500,000 or as much as AUD 2.5 million for the defendant. //

The largest costs are incurred during discovery. This is largely because discovery in securities class actions is highly asymmetric. The defendant is likely to have many thousands (or millions) of documents relevant to the securities class action at hand that the plaintiff may request. Each document needs to be found and then reviewed as to whether the plaintiff is entitled to them. This means that the cost of discovery bears a heavy burden on the defendant, whereas there are few discovery obligations on class members. This is due to the fact that in a class action, group members are not parties and therefore may not even be identified.

However, in ‘closed classes’ group members are known, and it has not been infrequent for defendants to request particulars – or apply for discovery – of group members in these instances. Typically, this stage will last for approximately 2 years and discovery may well last until the trial or settlement, as new information or facts are brought to the forefront. Discovery may cost as little as AUD 500,000 or as much as AUD 2.5 million for the defendant.

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21 https://www.classactionrecoverymutualfunds.com/2016/05/australian-court-manages-concurrent-class-actions-by-giving-the-class-members-a-choice/
The cost largely depends on the size of the claim in question. The larger the claim, the greater the number of issues that may arise and the greater the amount of documents that may be requested.

Evidence
Once the discovery period has concluded, both parties will gather and subsequently file their evidence. The time it takes for gathering evidence is approximately 12 months. Once both the defendant and plaintiff have filed evidence it will take between 6 to 12 months until the trial starts.

Application for proceedings to be discontinued
At this stage the defendant may choose to file an application for discontinuing the proceedings as a class action. Costs incurred by the defendant may amount to between AUD 20,000 and AUD 50,000.

Settlement
Having reached the settlement stage, parties will agree on an amount, occasionally in confidence, to settle the securities class action. The time in which class actions are settled can vary widely. In some instances settlement has been reached after trial has commenced and in other instances a settlement was reached several months before trial began.

Once a settlement is agreed upon by both parties, the Court is required to approve the settlement amount. However, prior to Court approval, both parties will file extensive reports on the fairness of the settlement. Once the proposed settlement is approved by the Court a notice must be issued to the absent class members, who are being represented by the representative plaintiff. Absent class members will then have the right to attend the hearing, where they can oppose or support the settlement. Once the Court holds the fairness hearing they will either approve the settlement or request amendments. Subsequent to a settlement being approved by the Court the settlement amount will be distributed among the class members, plaintiff law firm and litigation funder.

Court approval of the settlement is costly, and may impose significant additional expenses of as much as between AUD 20,000 and AUD 50,000.

Trial
Only four securities class actions have reached trial in Australia, two of which have gone to full trial. None of these have reached a final judgment. These types of trials would be expected to last between 6 and 12 months. A trial of this length would cost both the plaintiff party and the defendant between AUD 1 million and AUD 2 million.

Summary
Securities Class Actions are on the rise. This whitepaper acts as a guiding tool to navigate the current securities class action environment. Through analysing and understanding how law firms, litigation funders, plaintiffs, regulatory bodies and insurers have responded to the rise in securities class actions, we are able to forecast how claims handlers, underwriters and corporations operating in the Australian market can best tailor their future response to the threat of litigation.

An understating of securities class actions and an analysis of current proceedings afoot is crucial to assessing the implications securities class actions will have on insurers. Of significant importance is the evolving relationship between ASIC, plaintiff law firms and litigation funders. In order for underwriters and insurers to manage this exposure, it is essential to understand how D&O coverage responds to securities class action claims and when a policy is triggered. Subsequent whitepapers will look at how the insurance industry can respond to securities class actions to ensure insurers and insureds alike are prepared and well equipped.

// In April 2016, in the case of Kelly v Willmott Forests Ltd, the Court rejected a proposed settlement on the basis that the settlement agreement was not fair and reasonable. It was found the proposed settlement would only benefit a small portion of class members and included an unjustified amount for the solicitor’s costs. //
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W+K is recognised as having one of Australia’s most experienced Financial Lines practices. Our national D&O specialists are highly skilled in handling claims on behalf of both primary and excess insurers, as well as individual directors and officers across a diverse range of industries. We have acted in some of the most complicated and high-profile D&O class actions in Australia arising out of large financial collapses, and regularly act in small to medium sized D&O claims, both litigated and non-litigated. In addition to providing coverage advice and claims defence, W+K also advises insurers and brokers on D&O policy wordings and specific endorsements.

In January 2017, W+K became a founding member of Legalign Global, an alliance between four of the world’s leading insurance law firms along with BLD Bach Langheid Dallmayr (Germany), DAC Beachcroft (UK) and Wilson Elser (US). Legalign Global was developed in response to increasing globalisation and facilitates a more effective legal services response to global insurers and their customers participating in multi-national insurance programs.

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