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COMMENTARY

Federal Court of Australia Rejects "Common Fund" for Litigation Funders

Key Points

- The Federal Court has declined to make orders at the commencement of proceedings which would have endorsed a funder's fee arrangement (reimbursement of legal fees paid to the lawyers and payment of between 22.5 percent and 35 percent of any recovery) as reasonable and required all group members to pay that fee.
- The making of the orders would have removed the need for a litigation funder to contract with a group member to be paid and therefore allow for an open class action that included all group members rather than a closed class that was limited to group members who had entered into funding agreements. The Court found that the orders, while advantageous to the litigation funder, were not "appropriate or necessary to ensure that justice is done in the proceeding".
- Litigation funders will now need to consider how they structure their funding arrangements for Australian class actions. At least in the short term this is likely to mean the use of a closed class where group members are only included in the class action if they have entered into a funding agreement. Further, where there are unfunded group members in a class action, court orders will continue to be sought as part of any settlement for the unfunded group members to give up part of their recovery equivalent to that paid by funded group members.

Background

In the Allco shareholder class action, an application was filed by the two applicants/representative parties seeking court orders for the appointment of International Litigation Funding Partners Pte Ltd ("ILFP") as the funder of the class action on the terms of the litigation funding agreement entered into by the applicants. Clause 9 of the funding agreement provided for group members to reimburse the funder the amount of legal fees and disbursements paid by the funder and to pay a percentage of the Resolution Sum determined as follows:

Number of Shares Held	Resolution on or by 30 June 2014	Resolution on or by 30 June 2015	Resolution after 30 June 2015
< 1,000,000	25%	30%	35%
> or = 1,000,000	22.5%	27.5%	32.5%

As the judgment dealing with the application was handed down on 7 August 2015, the percentages to be charged were 32.5 percent or 35 percent. Further, if the funder funds an appeal of a final judgment, or the defence of an appeal from a final judgment, a further 5 percent of the Resolution Sum in respect of the appeal so funded is payable by group members.

Orders Sought

The orders sought by the applicants were that the court approve the amounts payable by the applicant and group members to ILFP pursuant to clause 9 of the funding agreements on the basis that they are "reasonable consideration payable to ILFP and expenditure incurred by the Applicants in prosecuting the proceeding" in exchange for the funding and an indemnity as to costs. Further, that the applicant was entitled to withhold the above amounts from any settlement or judgment and pay them to ILFP.

The making of the orders would have the result that all group members would be liable to pay the funder's fees (costs incurred by the funder and a percentage of any recovery) without having entered into any agreement. The orders, if made, would remove the need for a litigation funder to contract with a group member to be paid and therefore allow for an open rather than a closed class to be employed. The application would create a funding regime similar to the common fund approach employed in the United States for the payment of lawyers' fees in class actions.

Applicants' Argument

The Applicants advanced six reasons for why the Court should make the orders:

1 The order is analogous to other situations where a person has incurred expenses in recovering property for the ultimate benefit of others and has been held to be entitled to recover their costs, expenses and fees out of the recovered fund, e.g., a liquidator;
2 The proposed order ensures an equal and equitable outcome between all group members, regardless of whether or not they have entered into a funding agreement with ILFP;
3 The proposed order will secure a beneficial outcome for all group members by allowing for an open class that includes all group members, rather than a closed class where the group is limited to those persons who have entered into a funding agreement with ILFP;
4 The proposed order is consistent with the policy objectives of Pt IVA of the Federal Court of Australia Act 1976 (Cth) ("FCA Act") which creates and regulates class actions. Those policy objectives are said to be to enhance access to justice, reduce the costs of proceedings and promote the efficiency of court resources. An open class is more efficient and provides access to justice better than a closed class;
5 The proposed order appropriately protects the rights of group members because group members retain the right to opt out of the proceeding, the amount that ILFP may receive is reasonable having regard to funding premiums paid in other representative proceedings, and because the Court retains control over any settlement through the need to secure the approval of the Court under s 33V of the FCA Act; and
6 The proposed order is consistent with orders made in similar proceedings in Australia, the United States (which employs the common fund doctrine) and Canada.

The Court then considered whether it had power to make the orders sought.

Section 33ZF

The main power for the making of the orders was s 33ZF(1) of the FCA Act which provides:

> In any proceeding (including an appeal) conducted under this Part, the Court may, of its own motion or on application by a party or a group member, make any

order the Court thinks appropriate or necessary to ensure that justice is done in the proceeding.

Section 33ZF confers a broad power on the Court to make orders in relation to representative proceedings. The courts have been clear that it is not to be given a narrow construction.[1] The only express limitation or requirement in s 33ZF is that the Court thinks the order is appropriate or necessary to ensure that justice is done in the proceeding. The power is subject to discretion.

Reasoning

Wigney J considered each of the six arguments put forward by the applicants from the perspective of whether they engaged the requirements of s 33ZF. His Honour found that none did.

A representative party or applicant is not in an analogous position to a liquidator. In particular, while a representative party can commence proceedings on behalf of group members they have no authority to promise to pay the litigation funder a commission based on a percentage of any amounts recovered on behalf of other group members.

Further, it is neither appropriate nor necessary to impose the Applicants' commercial bargain in relation to the payment of a commission on the group members as a whole, at least at the beginning of proceedings. The fact that orders that have this effect have been made in the context of anticipated settlements, which require the approval of the Court under s 33V of the FCA Act, was said to not assist the Applicants. At the stage of settlement the court is in a better position to determine the settlement sum and the payment to be made to the litigation funder. The lack of information as to the amount that may be payable to the funders also went against the making of an order.

Wigney J stated that the only real rationale for making the order at this stage was to ensure the commercial viability of the proceeding from the perspective of the litigation funder, but that had nothing to do with ensuring that justice was done in the proceeding. Wigney J also observed that:

Justice "in the proceeding" would not ordinarily involve any consideration of the commercial interests of a litigation funder unless they gave rise to some issue or problem that has, or is likely to have, some direct impact on the proceeding.[2]

The court also rejected the argument that there would be an inequality between the group members if some may benefit from the funding without contributing to its cost. The issue of fairness amongst group members, including whether unfunded group members may "free-ride", could be dealt with should a settlement arise. The Federal Court has recognised, in the context of making orders facilitating or approving settlements, that fairness may require that group members who have entered into funding agreements should not end up in a worse position than group members who have not entered into funding agreements.

Wigney J then turned to consider the rights and interests of group members and the argument that the orders were consistent with the policy of Pt IVA. His Honour was not convinced that the order sought was in the interests of group members, at least at such an early stage of proceedings when so little was known about the possible outcome. The applicants' argument that without the order a closed class would be commenced, which would shut out some group members, contrary to the policy of Part IVA was seen as being driven by the interests of the funder rather than group members.

Wigney J considered the fact that notice had been given to group members and none had objected to the orders that were sought. While notice clearly had to be given, the fact that no objections were received is not determinative. The right to opt out does afford protection to group members, but here the proceedings had been commenced very close to the expiry of the statute of limitations. When this is combined with group members having small claims it is likely that opting out would equate with being unable to bring an action, and so its protective force was diminished. Wigney J also considered how the requested order would interact with s 33V and the requirement for the court to approve any settlement. While the applicants accepted that the court would retain the power to vary the orders sought as part of a settlement, Wigney J was concerned at how a court could practically do that if it had previously found the amounts payable to the funder as reasonable. His Honour also thought that the order may conflict with s 33ZJ which allows for costs reasonably incurred by an applicant to be reimbursed out of

any damages awarded to group members where those costs cannot be recovered from a respondent.

His Honour reviewed the case law in the U.S. and Canada but found it unhelpful due to differences between those jurisdictions and Part IVA of the FCA Act.

His Honour then turned to the discretionary aspect of s33ZF. Even if the power was engaged his Honour would not have exercised his discretion to make the orders because so much was unknown: the number of group members, the value of the damages claims in question, the amount of the commission that the court was asked to approve as reasonable consideration payable to ILFP, the likely length and complexity of the trial and the legal costs that would be incurred.

Law Reform

Although his Honour declined to make the sought after orders he did observe that there may be a case for legislative law reform to take account of the role of litigation funders. In particular, "there would need to be specific provision for scrutiny and court approval of the amounts payable to the litigation funder at the determination of the proceeding".[3]

Lessons

The current decision demonstrates the growing and significant role that litigation funding plays in relation to class actions. The judgment also recognised explicitly that funders structure class actions and their funding arrangements in their own self-interest.

The law around class actions has been developed by funders seeking to advance their interests through favourable precedent development. The closed class that was approved in the Multiplex class action is a clear example.[4] Wigney J examined the sought after orders from the perspective of their impact on group members as a whole and found that, while the orders may assist the funder, they were not in the interests of the group members. It must not be forgotten that the function of class actions is to pursue remedies for those allegedly wronged—not to make profits for litigation funders.[5]

The Allco decision means that litigation funders will in the short term continue to either employ a closed class definition or seek orders as part of any settlement to address the existence of unfunded group members. The former is problematic as it makes the funder (and the terms of its funding agreement) the gatekeeper of access to a class action and it can promote multiple class actions or other litigation.

The latter gives rise to a continuing debate as to how unfunded group members should be dealt with. Two broad approaches have been adopted to date. First is an equalisation order whereby unfunded group members have their recovery reduced by the amount the funded group members have paid to a litigation funder. This amount is redistributed across all group members. The second is the imposition of the funding agreement terms on unfunded group members so that they must pay the funder's fee to the funder. The former ensures equality amongst group members but without a direct payment to the funder. The second ensures equality but with the funder receiving a greater fee.

In the GPT shareholder class action Gordon J rejected the second approach because the funder had knowingly funded the class action without signing up all group members and the unfunded group members had not agreed to it—"[t]he deduction of the funding commission was never part of a commercial bargain".[6] Gordon J employed the first approach, in keeping with the practice in previous class actions. However, the second approach has been employed in at least two class actions—a shareholder claim in the Supreme Court of Victoria and a bank fees claim in the Federal Court.[7]

Lawyer Contacts

For further information, please contact your principal Firm representative or one of the lawyers listed below. General email messages may be sent using our "Contact Us" form, which can be found at www.jonesday.com/contactus/.

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Endnotes

1 *McMullin v ICI Australia Operations Pty Ltd* (1998) 84 FCR 1 at 4; *Courtney v Medtel Pty Ltd* (2002) 122 FCR 168 at [48]-[49]; *The Owners of the Ship "Shin Kobe Maru" v Empire Shipping Company Inc* (1994) 181 CLR 404 at 421; *Wong v Silkfield Pty Limited* (1999) 199 CLR 255 at [11].

2 *Blairgowrie Trading Ltd v Allco Finance Group Ltd (Receivers & Managers Appointed) (In Liq)* [2015] FCA 811 at [113].

3 *Blairgowrie Trading Ltd v Allco Finance Group Ltd (Receivers & Managers Appointed) (In Liq)* [2015] FCA 811 at [227]-[228].

4 *Multiplex Funds Management Ltd v P Dawson Nominees Pty Ltd* (2007) 164 FCR 275.

5 See *Treasury Wine Estates Ltd v Melbourne City Investments Pty Ltd* [2014] VSCA 351 at [14].

6 *Modtech Engineering Pty Limited v GPT Management Holdings Limited* [2013] FCA 626 at [57].

7 See *Pathway Investments Pty Ltd v National Australia Bank Ltd (No 3)* [2012] VSC 625; *Farey v National Australia Bank Ltd* [2014] FCA 1242.