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COMMENTARY

Game Changer: Appellate Court Permits Common Fund Orders in Australian Class Action Litigation

Key Points

- An upsurge in Australian class action filings is expected now that the Full Court of the Federal Court of Australia has permitted a common fund order in federal class action litigation.
- In what may prove to be one of the most significant rulings in Australian class action law, the Full Court in *Money Max Int Pty Ltd (Trustee) v QBE Insurance Group Limited* [2016] FCAFC 148 has, for the first time, made orders permitting a litigation funder to be paid a court-determined percentage from any fund created as a result of a successful class action settlement or judgment—i.e., a common fund order.
- Prior to this decision, litigation funders were compensated from the proceeds (be it a settlement or judgment) obtained by the subset of class members who had entered into a funding agreement with them. Now, all members of the class are likely to have to, in effect, contribute to the payment of a litigation funder's fee (whether or not they entered into a funding agreement with the funder).
- Other ramifications of this decision are expected to include:
  - a trend to larger class actions—because a common fund arrangement provides strong economic incentives for funders to run "open class" rather than "closed class" class actions; and
  - a race to the courthouse to file first among the promoters of class actions—because funders who can obtain a common fund order will be able to cause a class action to be filed without having to first build a book of class members who will enter a funding agreement. As such, the prospect is that funders will be keen to try to capture the ground for the class action by seeking to file ahead of rival class action promoters. A related concern is whether the race to the registry will see more, poorly considered, and poorly investigated class actions being filed. That prospect seems highly likely.

Background

The Australian class action regime in Part IVA of the *Federal Court of Australia Act 1976* (Cth) ("FCA Act") was introduced without any additional funding mechanism. Contingency fees were, and are, illegal. Lawyers could charge a conditional fee (also called a no-win, no-fee) where the client had to pay only if the claim were successful, but the lawyer received only his or her normal fee, in some cases with an uplift capped at 25 percent of that normal fee. However, this did not address the usual costs rule in Australian litigation where a losing party is liable for the other side's costs. The rule is modified in relation to class actions as the costs rule applies to the representative party only and not to the class members.[1] Nonetheless, this approach to costs has been raised as a disincentive to the commencement of litigation as the plaintiff, or representative party in a class action, is liable for the costs of their opponent if they are unsuccessful.

The response to the possibility of an adverse costs order pursuant to the Australian costs rule, and the lack of law firms being able to run lengthy, complex class actions on a conditional fee basis, was third-party litigation funding. However, funding was dependent on a contractual relationship being established. Litigation funders then became concerned about free-riding, where the opt-out class model adopted in Australia meant that unfunded class members could be part of a class action but not have to pay any fee to the funder. The funders addressed this through a "closed class" method of group definition. The closed class is brought only on behalf of those class members who entered into a funding agreement so that there were no unfunded class members.

However, competition between funders and a respondent's desire for finality saw, in some circumstances, the continued use of the traditional opt-out class action model, now called an "open class", or the opening of a closed class as part of a settlement to allow for unfunded class members to be included. To address the existence of the so-called free riders, a practice developed of seeking "equalisation orders" whereby unfunded class members were ordered by the court to give up a proportion of their recovery equal to what funded class members had agreed to pay to the funder. In most cases, the amount given up by the unfunded class members was then distributed across all class members, but in some instances it was paid to the litigation funder.

The academic literature recognised that while the opt-out class action and litigation funding both have the ability to promote access to justice, they were at odds with each other, leading to the closed class and, in some situations, multiple class actions. To try to address this problem, attention focussed on the US class action practice of employing a common fund approach to the payment of lawyer's fees and sought to adapt it to litigation funding. The idea, with some modifications, was picked up by funders and practitioners and, ultimately, the Full Court of the Federal Court of Australia.

Facts

Money Max Int Pty Ltd brought a shareholder class action against the respondent, QBE Insurance Group Ltd ("QBE"), pursuant to Part IVA of the FCA Act. The applicant alleged that QBE engaged in misleading or deceptive conduct and breached its continuous disclosure obligations.

The class action was funded by a litigation funder, International Litigation Funding Partners Pte Ltd ("Funder"). The applicant commenced the class action on its own behalf and on behalf of an "open class" comprising all persons who acquired an interest in QBE shares in the defined period and who claimed to have suffered loss as a result of QBE's conduct. The Funder and approximately 1,290 class members entered into a litigation funding agreement which provided that:

- The Funder agreed to meet the class members' legal costs, any adverse costs order and any security for costs.
- The class members agreed to reimburse the Funder the legal costs paid and to pay the Funder a percentage commission of either 32.5 percent or 35 percent (depending upon how many QBE shares they acquired in the defined period) from any settlement or judgment monies they received.

No funding agreement existed in relation to other class members.

The applicant sought orders pursuant to ss 23 and 33ZF of the FCA Act to require the applicant and all class members to pay the Funder a pro rata share of the legal costs incurred and a funding commission at the (reduced) rate of 30 percent from the common fund of any settlement or judgment in their favour. The effect of the order would be to apply litigation funding terms to all class members (not just the funded class members) without class members needing to enter into a contractual relationship with the Funder.

The Full Court's Proposed Orders

The Full Court determined that it would make orders similar to, but not precisely the same as, those sought by the Applicant. The Full Court stated that once the Funder, the Applicant and the Applicant's solicitor gave an undertaking to each other and to the Court that they would comply with the funding terms set out in annexure A to the judgment, the Court would order that prior to any distribution to class members, the following amounts be deducted from any settlement or judgment and paid to the Funder: (i) the legal costs paid by the Funder to the lawyers; and (ii) a percentage of any settlement or judgment to be determined by the Court.

However, no amount payable pursuant to the order could be greater than would be payable if the order was not made, i.e., the terms of the funding agreement applied.

A number of matters are apparent:

- The operation of the common fund is at the election of the Funder—the Funder can elect to retain the contractual arrangements with the funded class members.
- The Court will determine the amount of the Funder's commission at the conclusion of the proceedings once a settlement or judgment has occurred.
- All class members will bear the legal costs and the Funder's commission equally.
- No class member can be worse off under the orders than if the orders were not made.

More Class Actions?

The availability of common fund orders may make it easier for a litigation funder to satisfy themselves that the quantum of claims is sufficient to make funding a worthwhile proposition without needing to wait until they have signed up the requisite number of class members. The common fund also reduces the cost of identifying and signing up class members. As a result, class actions that may not have been commenced because the "book build" process failed to attract sufficient signatures may now go ahead. That said, the common fund does not change a class action's prospects of success in relation to the substantive claims, and the Australian costs rules mean that the class representative (usually indemnified by the funder) will be required to pay an opponent's costs if the class action is unsuccessful.

Larger Class Actions?

It is generally the case that an opt-out class action will be larger than an opt-in class action, at least initially. This also holds for the Australian variant on the opt-in class, the closed class. This is because the opt-out class action includes everyone who meets the class definition without them needing to do anything. At an early stage, they will be given an opportunity to exclude themselves by taking the positive step of returning a form. A closed class is typically smaller because the lawyer or funder has to sign up each class member, which takes time, money and an ability to actually identify the class member.

As the common fund does not require a funder to have signed up a class member to get paid, it should encourage the use of an open class action. As a result, the funded open class action is likely to include more class members than the funded closed class action, and it is likely to be used more often, subject to the comments below about competing class actions.

However, when class actions conclude, there is a need to be able to distribute any compensation achieved. For a closed class, that is relatively straightforward since class members are known. For an open class action, there will need to be a class closure process whereby the class members register, meaning they provide contact details, bank account information and claim information. The closure of the class is needed regardless of whether a common fund order is to be made. The effect of class closure is usually that those class members who do not register do not recover any compensation, but they have their claim extinguished.[2] The size of the class action crystallises at this point and usually reduces.

Whether an open class after it has been closed will still be larger than a closed class will vary across class actions depending on a range of factors. However, in relation to shareholder class actions that were closed classes but then opened, the result was usually more class members participated and an increase in quantum. The number of class members can increase substantially, but the quantum increases to a far lesser degree because the closed class usually targets institutional investors with large shareholdings. The additional class members who registered were usually retail investors with small shareholdings.

More or Less Competing Class Actions?

The Full Court expressed the view that "by encouraging open class proceedings, a common fund approach may reduce the prospect of overlapping or competing class actions and reduce the multiplicity of actions that sometimes occurs with class actions".[3]

However, competing class actions are still possible, indeed highly likely, due to the increasing numbers of funders and plaintiffs' lawyers seeking to operate in the Australian class actions market.

This is because the common fund is but one of a number of ways to finance a class action. Class actions can be structured as open or closed classes. Financing can come from a litigation funder or from a lawyer acting on a conditional fee basis and with an After-the-Event insurance policy to cover any adverse costs order. Further, the terms of the financing will vary, the most obvious being the percentage of the funder's commission or the rates charged by the lawyer, including the amount of any uplift (capped at 25 percent by legislation). The common fund adds another item to the financing menu.

Some funders will not want to place their recovery in the hands of the court through the common fund and prefer to rely on the terms of their funding contracts. The Full Court acknowledged as much.[4] Of course, a court probably has the power to review a funder's fee regardless of a common fund order being made. The common fund order makes it easier by having the funder agree upfront. Established funders with connections to institutional investors may feel they can contract with a sufficiently large number of claimants to make undertaking the risk for the potential return worthwhile. If they have to open the class, then they can seek equalisation orders.

Class members, especially institutional investors, may have a preference for a particular funder because they can negotiate lower fees. The funding agreement used in *Money Max* gave large shareholders a 2.5 percent discount compared to small shareholders. The funder's reputation or solvency or other nonfinancial terms in the funding agreement may play a part.

There is no common fund order available for lawyers, and so they may find it more lucrative to bear the risk of receiving no payment in return for being able to charge their standard hourly fees and obtain a 25 percent uplift to those fees if successful. This approach is rare in the shareholder class action space at present but was used in the Bushfire class actions, where the lawyers in the Kilmore East class action recovered $37 million.[5]

The Full Court's view above follows from a single open class action being able to include and resolve all class members' claims. Other class actions or proceedings are not needed. If multiple open class actions are commenced, then there is a clear abuse of process as class members will be suing a respondent multiple times for the same alleged harm. The court can choose between the class actions using its traditional tools of stay, joinder and consolidation. Matters become more complicated when the class members do not overlap, such as when there are two closed classes or an open and a closed class but the open class excludes the class members in the closed class. There is no abuse of process, but there are additional costs for the court, the parties and the class members compared to if there were a single open class action.

The court needs to be prepared to draw on its case management powers to choose a single vehicle to resolve the claims. To date the courts have been reluctant to do so, especially when the class actions have different financing models and/or vary in terms of allegations made or claim period. The common fund does not remove the need for the courts to make some difficult decisions in relation to competing class actions. However, as it may foster a race to the courthouse, it may then force the court into making those difficult decisions.

A Race to the Courthouse?

The common fund order removes the need for a funder to first contract with sufficient class members to be able to launch a class action with sufficient quantum of claims to make funding a worthwhile proposition. Given the increasing numbers of new funder entrants in the Australian class actions market, the common fund presents an opportunity for those new entrants to commence class actions quickly and stake out the ground in the hope of being the funder for all class members.

The courts have previously stated that the first class action to be filed does not automatically become the one that will proceed. However, it does present a funder with some advantages, such as the associated publicity which can assist in attracting class members (even though a litigation funding contract is not strictly necessary if a common fund order is made), and as a way of discouraging other competing classes who will recognise that the process will be longer and more complicated than originally envisaged. Nonetheless, there are a number of large, well-established funders operating in Australia who are unlikely to give up a lucrative class action because another class action has already been filed.

The result will be more competing class actions that will need to be sorted out by the courts. However, it may also result in large-scale opt outs, where a funder has contracted with institutional investors and another procedural approach is available, such as regular litigation with all investors joined as claimants.

Lower Funder's Fees?

The Full Court stated that it expected "the courts will approve funding commission rates that avoid excessive or disproportionate charges to class members but which recognise the important role of litigation funding in providing access to justice, are commercially realistic and properly reflect the costs and risks taken by the funder, and which avoid hindsight bias".[6] The way in which the courts approach the setting of the funder's commission, and the actual fees approved, will be crucial to how the common fund is employed going forward. It remains to be seen whether the fees will be reduced.

Lawyer Contacts

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Endnotes

1 *Federal Court of Australia Act 1976* (Cth) s 43(1A).

2 *Money Max Int Pty Ltd (Trustee) v QBE Insurance Group Limited* [2016] FCAFC 148 (*Money Max*) at [189].

3 *Money Max* at [14].

4 *Money Max* at [81].

5 *Matthews v AusNet Electricity Services Pty Ltd* [2014] VSC 663 at [384].

6 *Money Max* at [82].