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COMMENTARY

Australian Federal Court Has Power to Reduce Litigation Funder's Commission Payable in a Class Action

Key Points

- The Federal Court of Australia has taken further steps to provide judicial oversight of litigation funding arrangements in a class action.
- Previous decisions of the Court had held that it possessed the power to refuse to give a settlement approval where the funding commission was considered excessive, or to make any approval subject to a condition limiting the funding commission. In *Earglow Pty Ltd v Newcrest Mining Limited* [2016] FCA 1433 ("*Earglow v Newcrest*"), the Court went a step further by finding it had power to directly reduce the funding commission to be deducted under the settlement.

Background

Earglow Pty Ltd ("Earglow") commenced a shareholder class action against Newcrest Mining Ltd ("Newcrest") for misleading and deceptive conduct and contraventions of continuous disclosure obligations. This action was supported by a class action litigation funder ("Funder"). Earglow's application was made on behalf of an open class comprising persons who had purchased Newcrest shares in the period from 13 August 2012 until 6 June 2013 and suffered loss.

Pursuant to orders made on 29 July 2015, members of the class were given the opportunity to opt out of the class action. If they did not opt out, they were required to register their interest to pursue their claim in the class action. Following the registration process, a large number, but not all, of the registered class members entered into a funding agreement with the Funder.

An agreement was reached on 21 February 2016 under which Newcrest would pay $A36 million in full and final settlement of the class action. The settlement agreement stipulated that this sum was to be distributed to all registered class members pursuant to a settlement distribution scheme. Under this scheme, class members authorised their solicitors to pay a funding commission to the Funder which ranged between 26 percent and 30 percent of each award distributed to individual shareholders, depending on how many shares a given class member had purchased. An equivalent deduction was to be made for class members who had not entered into the funding agreement. Following settlement, Earglow applied to the Federal Court to gain court approval of the settlement as required by s 33V of the *Federal Court of Australia Act 1976* (Cth) ("Act").

Decision

The key issue for the Court was whether the settlement was in the interests of the class members. This required the Court to determine whether the settlement was fair and reasonable. In the course of assessing fairness, a question arose regarding the Court's power to reduce the percentage of the commission to be paid to the Funder. Previous decisions of the Court had found that s 33ZF may provide the power to refuse to give a settlement approval where the funding commission was considered excessive, or to make any approval subject to a condition limiting the funding commission. Here the Court went a step further by considering whether it had power to directly reduce the funding commission to be deducted under the settlement.

Two provisions of the Act were pivotal in this case. The first was s 33V. Section 33V(1) provided that class action proceedings could not be settled or discontinued without the approval of the Court, while s 33V (2) provided that if the Court approved the settlement, it was able to make such orders as were just with respect to the distribution of money paid under the settlement. The second was s 33ZF(1), which enshrined a general power to "make any order the Court thinks appropriate or necessary to ensure that justice is done in the proceeding".[1] Earglow presented three key arguments as to why the Court did not have the power to, or otherwise should not, vary the funding commission:

- There was no statutory basis that gave the Court the power to interfere with the freely assumed contractual rights and duties of the class members and the Funder;[2]
- Section 33ZF provided the Court only with the power to ensure that justice be done "*in the proceeding*", and, as the entry into the funding agreement was not part of the proceedings, varying the terms of the funding agreement was beyond the jurisdiction of the Court. Moreover s 33ZF only operated where there was an element of necessity for the making of orders;[3] and
- It is quite common for funding agreements to provide that if any part of the agreement is annulled, then class members have an obligation to remunerate the funder the amount to which they were entitled under the agreement. Such a clause was present in this case. Accordingly, Earglow submitted that reducing the commission would be ineffective because the Funder could simply recover the balance of its contractual entitlements by consent or separate proceedings.[4]

In regard to Earglow's argument regarding freedom of contract, the Court expressed the view that the terms of the funding agreement did not necessarily contain freely assumed contractual rights and duties. The Court drew attention to the fact that the funding agreement imposed terms on the unfunded class members who had never agreed to the funding agreement. Further, the Court was influenced by the fact that class members who had agreed to the funding agreement had not enjoyed true freedom of contract as they had suffered a significant degree of information asymmetry and an extremely limited role in the pre-contractual negotiations. The Court did not accept that reducing the funding commission would be an affront to the contractual autonomy of either Earglow or the Funder, as those parties had known that there was a chance the Court might not accept whatever commission was agreed upon. In explaining its decision, the Court went on to discuss how various provisions of the Act had been given liberal readings to empower courts to deal with difficulties that may arise in the context of third-party funding.

The Court also rejected Earglow's argument that it did not have the power to reduce the funding commission. The Court held that the power to reduce the funding commission was founded upon the Court's duty to ensure that a settlement is fair and reasonable, having regard to the interests of the class members, as required by s 33V(1). This finding was further supported by a wide reading of the words "any orders as are just with respect to the distribution of any money paid under a settlement" as they appear in s 33V(2). Section 33ZF was also enlivened to protect class members' interests, and the terms of a funding agreement impacted on justice in the proceeding.

Finally, the Court dismissed Earglow's argument that a litigation funder could recover amounts owing to them as a contractual entitlement. The Court said that an order could be made simply preventing the funder from bringing such a claim.

However, the Court did not see fit to exercise its power to reduce the funding commission in this case and ultimately found that the settlement was fair and reasonable, notwithstanding that the unregistered class members had not been

notified of the settlement. The Court approved the funding commission, remarking that the percentage was quite low given the risk taken on by the funder in pursuing the claim.

Ramifications

Earglow v Newcrest follows on from the Full Federal Court's decision in *Money Max Int Pty Ltd (Trustee) v QBE Insurance Group Limited [2016] FCAFC 148* ("*Money Max*"), where the court showed a greater willingness to provide judicial oversight of litigation funding arrangements. In *Money Max*, the Full Court permitted a litigation funder to be paid a court-determined percentage from the fund created as a result of a successful settlement or judgment.[5] However, in the context of those common fund orders, the funder was required to consent to that order being made at the beginning of proceedings. The funder could choose to proceed without a common fund order. In situations similar to *Earglow v Newcrest* where a court varies the funding agreement as part of settlement approval, the funder has not consented to the variation, nor can they resist the variation other than on appeal. In this respect, the decision in *Earglow v Newcrest* goes a step further than the Full Court's decision in *Money Max*. The decision in *Earglow v Newcrest* is also likely to promote the acceptance of common fund orders, as the uncertainty of the final funding commission determined by a Court has now been extended to all funding agreements used in Federal Court class actions.

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 The Court also made peripheral reference to two other sections. First, the broad power under s 23 to make any order or writ deemed appropriate in class action proceedings. Second, the powers under s 33Z that gave the Court various powers in relation to deciding class actions and awarding damages.

2 *Earglow Pty Ltd v Newcrest Mining Limited* [2016] FCA 1433 at [126].

3 *Ibid* at [130]-[131].

4 *bid* at [128].

5 *See* Jones Day, "Game Changer: Appellate Court Permits Common Fund Orders in Australian Class Action Litigation" (November 2016).