Victorian Law Reform Commission

ACCESS TO JUSTICE—LITIGATION FUNDING AND GROUP PROCEEDINGS

PROFESSIONAL STAKEHOLDERS' ROUNDTABLE 3 - SETTLEMENT OF CLASS ACTIONS

SUBMISSIONS BY LITIGATION LENDING SERVICES

COMMON FUND ORDERS AND FINALITY

Discussion of the implications of the use of common fund orders and, in particular, the impact on:

- Open classes, Closed classes and class closure
- The number and type of class actions, including competing class actions
- The interests of class members
- Efficiency
- The role of the court

Impact on type and number of class actions

Traditionally, **closed classes** have been favoured by funders as they provide certainty and the funder knows who it is providing its funds and services to, and there are corresponding contractual rights and obligations between the funder and the group members. The funder is not providing funding for an unidentified number of 'free riders'. The downside for funders is that this is dependent on the success of the book build; motivating claimants to participate in some actions is more difficult than others and the actual physical process of signing claimants up can be more difficult in certain actions, particularly if they are unsophisticated.

The downside for claimants with a closed class action is that if they don't become aware of the claim or they choose not to sign up then they won't be part of any outcome. There may be an opportunity later if the class is subsequently opened (eg for settlement) but that is only a possibility. The reality is that most claimants won't agitate to bring their own action, so if they are not happy with the terms being offered by the funder or the law firm bringing the claim then they really have no other option.

With closed classes, you can have competing actions running independently and claimants can choose which one to sign up to. This is good for claimants but not for defendants. Although this may be perceived as inefficient, in some cases the competing classes may have different claim periods or claims.

Open classes have the advantage of including all in the claim and outcome (with the claimant not locked in as they can opt out), thus promoting efficiency and certainty. Respondents usually don't have to worry about subsequent actions being brought and can write off that risk once the claim is resolved (unless there is a claim with a different claim period or different claims). It is easy to understand why class actions were originally conceived this way, with one action to represent the entire group, and relative certainty for the Respondent.

However, an open class claim may not cover all potential claims as there may be different claim periods for different claimants, as well as different claims and issues peculiar to individual group members. Eg the *Timbercorp* decision- 2016, High Court. There is scope for class members in an

open class proceeding to subsequently raise in later proceedings issues which were not finally resolved in the open class action, even though they did not opt out of the action.

For the first time in *Money Max*, the Full Court approved a common fund at the **commencement** of proceedings (whereby the funding terms are applied across an open class to all class members and not just those who have signed funding agreements) but subject to the funder agreeing to defer approval of its commission to settlement approval stage when the court could make a more fulsome assessment of the return to the funder and the risks it has borne. The court also applied a 'no worse off' rider so that group members could not be worse off than compared to if a funding equalisation order was made.

Previously, courts had made common fund orders at settlement to facilitate the settlement (*Pathways v NAB* and *Farey v NAB*) but not at the commencement of the action.

Money Max was followed by a decision of Beach J in *Allco*, in which his Honour initially rejected a common fund application which was made early on but then approved a common fund at settlement approval, stating "*I consider that as part of any approval order…I have power in effect to modify any contractual bargain dealing with the funding commission payable out of any settlement proceeds"* and *"If I make an order that out of monies paid by a respondent, a lesser percentage than that set out in a funding agreement is to be paid to a funder, that is an exercise of statutory power which overrides the otherwise contractual entitlement."*

Efficiency

Because common funds encourage open classes, this leads to more competing open classes and 'beauty parades' between funders and lawyers. Eg *Bellamys*- ICP (Maurice Blackburn) and IMF (S&G)- both open classes with roughly equal books. Beach J ordered that the IMF action continue as an open class and the ICP action continue as a closed class, limited to the current book. Orders were also made to encourage efficiency- one counsel team, solicitors jointly engaging with the Respondent on discovery and an independent solicitor monitoring the legal work.

A common fund also means the formal bookbuild can cease. However, it is important to acknowledge that the Applicant's solicitors still need to effectively register claimants and gather data for any loss quantification, and settlement discussion. The efficiency achieved here is one that is associated with the timing of commencement rather than dispensing with the process of registration entirely.

At settlement, Respondents typically want the class to be an open class so that it knows its liability for a particular claim will end with the settlement. Funders are more likely to agree to this if a common fund order is made because they will benefit from the order. Common funds therefore facilitate settlements. However, if the court will not approve the commission until the settlement approval application this means a funder has no certainty as to what it will ultimately receive. This may lead to some funders rethinking their presence in the market and could potentially impact access to justice. The comparison to the US and court approval of contingency fees is not a true comparison because there is no loser pays rule in the US and a law firm acting on a contingency basis is not the same as a direct outlay of funds by a funder.

Role of court and interests of class members

Should the court have an active role in determining the reasonableness of a commission charged by a funder? The Federal Court has pointed out that it has a very broad discretion under section 33ZF(1) to "*make any order the Court thinks appropriate or necessary to ensure that justice is done in the proceeding*". In addition, section 33V provides that any proposed settlement or discontinuance of representative proceedings requires approval of the court, "*which may make such orders as are just with respect to the distribution of any money paid under a settlement or paid into Court*".

Most would agree that where you are binding group members to a contract with the funder when they have not opted to do so, there should be some role for the court to play in supervising that process. But the question is, how far should that go?

In *Allco* the commission proposed was 30% of the net settlement sum, equivalent to 22% of the gross settlement, producing the following distribution scenario:

Settlement- $40m
Costs- $10.5m
Commission- $8.85m (30%)
Net amount to group- $20.61m

The funder ultimately paid $2m for disbursements and $7.25m for security. An outlay of $9.25m for a return of $8.85m is not over 3½ years, relatively speaking, what a funder would consider a good average return on its investment.

A commission of 22% is at the very low end of the funding market; some funders charge in the order of 40-45% so it is a very real issue that if the court perceives 20-25% to be an appropriate 'average' rate then funders may take their funds elsewhere, which would negatively impact access to justice. This is not to say that 20-25% is unreasonable in some cases, but if that becomes the average norm approved by the courts across all class actions (other than exceptional cases), then for some funders it will be a real disincentive. Will the courts ultimately end up regulating the market and setting the rates or will it be a true case-by-case assessment of reasonableness? It seems likely that the impact of the courts setting commission rates will lead to a downward shift.

Beach J in *Allco* stated that applying a commission equal to 30% of the net settlement sum on a net settlement above $50m would be difficult to justify. As a standalone statement, without referencing a particular context, this is disquieting from a funder's perspective as it does not factor in the significant costs paid by a funder (including security), the risk of an adverse costs order plus the time that the funds are tied up. For example, in a case like *Allco* which ran for 3½ years, cost $10.5 m to run with the funder paying $2m of those costs and the funder also providing $7.25m in security, that is a very significant outlay in funding and risk, with no return on the funds for 3½ years.

These are of course all very subjective factors. It is very difficult to draw a conclusion based on a range of factors like these that a particular commission is or is not reasonable when that assessment is made after the fact. Courts have indicated a reluctance to approve a commission early in the proceedings when they do not know what the outcome will be. However, a hindsight approach to this question doesn't acknowledge that when a claim is brought and funded there are no guarantees

that it will be successful or that the outcome will be commercially worth the investment for a funder.

It is understandable that courts have a desire to protect the interests of the passive majority in class actions, especially when at settlement and unless they have opted out, their claim will be finally determined. But this should be tempered with an approach that recognises the very significant risks that are borne by funders and lawyers, with no certainty of outcome. It is easy to look at a settlement and say that the funder is receiving a reward that is too high given the funding it *ultimately* paid and the risk *ultimately* borne, but that fails to take into account that if a claim is lost then the downside for a funder can be very severe. There are no guarantees in litiation.