Full Federal Court adopts common fund approach in open class representative proceedings

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Introduction

1. In *Money Max Int Pty Ltd (Trustee) v QBE Insurance Group Limited,*[1] the Full Court of the Federal Court of Australia has said that it proposes to make a 'common fund order' in relation to the litigation funding charges and legal costs of an 'open class' representative proceeding brought under Pt IVA of the *Federal Court of Australia Act 1976* (Cth) ("**FCA Act**").

2. The Full Court was satisfied that the proposed order, to be made at an early stage of the proceeding, was within power and was appropriate to ensure that justice was done in the proceeding pursuant to ss 33ZF and 23 of the FCA Act. Although the Full Court's decision was based on the interests of justice in the proceeding rather than on broader policy considerations, the Full Court said that a common fund approach to litigation funding charges and legal costs was consistent with the aims of Pt IVA of the FCA Act.

3. Significantly, the proposed order will only be made if the litigation funder gives an undertaking that it will comply with funding terms which provide for the percentage rate of the litigation funding charges to be later fixed and approved by the Court.

4. The Full Court has given the parties an opportunity to make further submissions on the proposed order before pronouncing it.

Relevant provisions

5. Part IVA of the FCA Act contains a regime dealing with representative proceedings (or class actions).

6. Section 33ZF of the FCA Act enables the Court, in any proceeding conducted under Pt IVA, of its own motion or on application, to "make any order the Court thinks appropriate or necessary to ensure that justice is done in the proceeding."

7. Section 23 of the FCA Act confers a more general power on the Court, in relation to matters within its jurisdiction, to "make orders of such kinds … as the Court thinks appropriate."

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[1] [2016] FCAFC 148.

Substantive proceeding

8. The substantive proceeding was a shareholder class action brought by the Applicant in the Federal Court of Australia against the Respondent under Pt IVA of the FCA Act. The action was brought by the Applicant on its own behalf and on behalf of an 'open class' comprising all persons who had acquired an interest in the ordinary shares in the Respondent during a defined period and who claimed to have suffered loss or damage as a result of alleged misleading or deceptive conduct by the Respondent and alleged breaches by the Respondent of its continuous disclosure obligations.

9. The action was funded by a litigation funder, International Litigation Funding Partners Pte Ltd ("**Funder**"). The Applicant and a group of class members ("**Funded Class Members**")[2] had each entered into a litigation funding agreement in the same or similar terms with the Funder ("**Funding Agreement**"). The balance of class members had not entered into a Funding Agreement ("**Unfunded Class Members**").

10. Under the terms of each Funding Agreement, the Applicant and the Funded Class Members agreed that, in consideration of the Funder agreeing to pay their legal costs and disbursements, any adverse costs order and any security for costs, they would, from any settlement or judgment moneys received:

    - reimburse the Funder for the legal costs which had been paid in respect of the action; and

    - pay to the Funder a 'funding commission' calculated on the basis of a percentage of either 32.5% or 35%[3] of the amount received.

11. The Unfunded Class Members, not being parties to any Funding Agreement, were not liable to pay any legal costs or funding commission to the Funder but stood to benefit from the collective financing of the proceeding by the Applicant and the Funded Class Members if they did not opt out of the proceeding and a favourable settlement or judgment was achieved.

Application for common fund order

12. The proceeding was still at an early stage and no date had been fixed before which class members could choose to opt out of the proceeding[4] when the Applicant filed an interlocutory application seeking a common fund order pursuant to s 33ZF of the FCA Act.

13. The common fund order principally sought by the Applicant required the Applicant and all class members (including the Unfunded Class Members) to pay to the

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[2] As at the date of hearing of the application for the common fund order, there were some 1,290 Funded Class Members.

[3] The rate depended on how many shares in the Respondent the class member had acquired in the defined period.

[4] Above, n 1, at [18]-[19]. Discovery was not complete and no evidence had been filed.

Funder, from the common fund of any settlement or judgment made in their favour, the legal costs incurred by the Funder and a funding commission at a reduced rate of 30%. The order was to be conditional upon the Funder giving an undertaking that it would comply with the revised funding terms.[5]

14. All class members were given notice of the application. There were only two objections of any consequence and they were ultimately determined to have little significance to the decision on the application.[6]

15. The application was referred to the Full Court of the Federal Court for hearing and determination.[7]

Respondent's objections

16. The Respondent raised numerous objections to the proposed common fund order.[8] Its principal objection was, in broad terms, that the Court was likely to make a 'funding equalisation order' in the proceeding as part of any settlement approval and that class members would receive more of any settlement or judgment under such an order than under the proposed common fund order.

17. The Respondent claimed that a funding equalisation order would provide for deductions from the settlement moneys payable to Unfunded Class Members of amounts equivalent to the funding commission that they would have been obliged to pay if they had entered into a Funding Agreement and that those amounts would be distributed pro rata across all class members, so that both Funded Class Members and Unfunded Class Members would receive the same proportion of their settlement or judgment. Accordingly, equality of treatment would be achieved between all class members.

18. In contrast, the Respondent said that a common fund order would benefit the Funder at the expense of class members because it would result in a substantial and unjustified increase in the aggregate funding commission paid to the Funder compared to the funding charges payable under a funding equalisation order. All class members would, therefore, ultimately receive a significantly lower proportion of any settlement or judgment moneys.

19. Other objections made by the Respondent included the following:

- A common fund order would constitute an unnecessary financial hurdle to the resolution of the proceeding.
- The Court lacked the power to make the common fund order.

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[5] Above, n 1, at [3]; [30]-[34].
[6] Above, n 1, at [4]; [36]-[51].
[7] Above, n 1, at [20].
[8] Above, n 1, at [5]-[6];[52]-[65].

The Full Court's proposed orders

20. The application was heard by Murphy, Gleeson and Beach JJ who delivered a unanimous decision ("**Full Court**").

21. The Full Court's decision was that it was appropriate to ensure that justice was done in the proceeding by making orders generally in the terms sought by the Applicant, but with some amendments, the most significant of which was that the funding commission rate would not be fixed at 30% or at any percentage rate but would be a matter for approval by the Court at a later time.[9]

22. Accordingly, the Court said that, upon the provision of an undertaking by the Funder, the Applicant and the solicitors for the Applicant that they would comply with their obligations under litigation funding terms set out in Annexure A to the reasons for judgment (which included that the Funder would be paid as consideration for the funding of the proceeding a percentage funding commission as approved by the Court), the Court would make orders which required all class members to pay the same pro rata share of legal costs and funding commission from the common fund of any amounts class members received in settlement or judgment in the proceeding. The proposed orders included a condition that no amount payable by class members was to exceed an amount that would otherwise have been payable by them if the orders had not been made [10]

23. However, the Full Court indicated that it would give the parties an opportunity to make further submissions on the proposed orders before pronouncing them.[11]

24. The Full Court said that the effect of the proposed orders was to:

> "*impose the burden of the legal costs and litigation funding commission costs incurred in the proceeding equally upon all class members who stand to benefit from the proceeding, not just upon funded class members.*"[12]

25. In reaching its decision, the Full Court took note of the backdrop against which the application fell to be considered which included the following:

    - Courts had routinely ordered all class members to pay a proportionate contribution to the legal costs incurred in producing a settlement and, given that litigation funding charges had become a standard cost in shareholder class actions, there was no reason in principle for treating litigation funding costs differently from legal costs.

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[9] Above, n 1, at [67].
[10] Above, n 1, at [8]-[10]; [67]. The Annexure A Funding Terms provided that the funding terms in Annexure A would prevail over any inconsistent terms in the Funding Agreement and in the solicitors' retainer agreements: see paras 16 and 17.
[11] Above, n 1, at [10].
[12] Above, n 1, at [8].

- It was established that the Court's supervision of legal costs charged to class members was appropriate and a similar view should be taken in relation to the supervision of litigation funding charges.

- The growth in litigation funding of representative proceedings had not been foreseen at the time Pt IVA was enacted and it was time that the Court gave further consideration to the interests of class members in relation to the reasonableness of litigation funding charges.[13]

Safeguards included in the proposed orders

26. The Full Court was satisfied that the proposed orders were to the benefit of class members and would not cause any material detriment to class members' interests.[14] The Full Court said that the proposed orders included the following three safeguards.

Court approval of funding commission rate

27. The first safeguard was the provision for Court approval of a reasonable funding commission rate at a later time (probably at the stage of settlement approval or at the point of distribution of damages) which was said to protect class members' interests because the Court would then have available to it more probative and more complete information, including information as to quantum or likely quantum of the settlement or judgment.[15] Court approval of the rate was said to compare favourably with the existing position for class members in the following ways:

    - While not attempting to bind the judge who would hear the application as to what was a reasonable funding commission rate in all the circumstances, Court approval of the rate would benefit the Funded Class Members because it was highly likely that the funding commission would be approved at a rate lower than the 32.5% or 35% which the Funded Class Members were contractually bound to pay under the Funding Agreement.[16]

    - There was no cap currently imposed on the aggregate funding commission which Funded Class Members were contractually bound to pay so in the event of a very large settlement or judgment, the Funded Class Members could be obliged to pay to the Funder an amount which could be excessive or disproportionate to the risk taken by the Funder. The proposed orders would significantly ameliorate or even avoid that consequence for Funded Class Members because the Court could decide it was appropriate to take the

[13] Above, n 1, at [68]-[76].
[14] Above, n 1, at [8].
[15] Above, n 1, at [11]; [79]. While the Full Court said that relevant considerations for the approval of a reasonable funding commission rate would be a matter for the judge hearing the approval application and would depend upon the circumstances, the Full Court nevertheless set out at [80] a number of considerations which it said would be likely to be included in the relevant considerations. See also the Full Court's comments at [103].
[16] Above, n 1, at [11];[84]-[85].

quantum of the settlement or judgment into account when approving the funding commission rate.[17]

- As for the Unfunded Class Members, if a funding equalisation order was made, they faced the prospect of deductions being made from their recoveries of an amount equivalent to the funding commission rate of 32.5% or 35% charged to the Funded Class Members under the Funding Agreement. However, under the proposed orders, all class members would have the protection inherent in the Court approval of a deduction at a potentially (and highly likely) lower rate as the Court considered reasonable in all the circumstances. Furthermore, it would also be to the benefit of Unfunded Class Members if the Court capped the aggregate funding commission.[18]

28. The Full Court said that Court approval of the funding commission rate was "central to our decision",[19] was the "central benefit for class members"[20] and undermined the Respondent's argument that class members would be worse off under a common fund order compared to a funding equalisation order.[21]

29. The Full Court did, however, make the comment that its decision not to fix the funding commission rate at 30% and provide for the Court to revisit that rate at the time of settlement approval, did not mean that it would always be necessary or appropriate to refuse to fix the funding commission rate until the time of settlement approval. The Full Court emphasised that it would always depend on the circumstances of the case.[22]

30. The Full Court acknowledged that the Funder could be "discomforted" by having to fund the proceeding when its consideration was not fixed and was subject to Court approval and that the Funder might decide not to offer the required undertaking, in which case the proposed orders would not be made.[23] However, the Full Court said that that was a matter for the Funder and that as the jurisprudence around Court approval of litigation funding charges developed over time any such concerns on the part of litigation funders would diminish.[24] The Full Court went on to say as follows:

> "*We expect that 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.*"[25]

[17] Above, n 1, at [11]; [86]-[89].
[18] Above, n 1, at [11]; [90]-[91].
[19] Above, n 1, at [11].
[20] Above, n 1, at [79].
[21] Above, n 1, at [79]. See also [97]-[108].
[22] Above, n 1, at [148].
[23] Above, n 1, at [81].
[24] Above, n 1, at [81]-[82].
[25] Above, n 1, at [82]

31. The Full Court also considered that Court approval of the funding commission rate would not be a problem because there was no indication in the USA that the requirement for court approval of the contingent percentage fee at the end of a class action had so reduced attorneys' returns that they were unwilling to bring class actions.[26]

32. The Respondent argued that the Court already had power to reject the funding commission rate under the Funding Agreement but, without expressing a concluded opinion on this, the Full Court observed, having regard to the authorities, that there were questions as to the Court's power to interfere with the terms of arms-length commercial agreements made between a litigation funder and funded class members, and as to the appropriateness of any such interference. In these circumstances, the Full Court considered that the requirement of an undertaking by the Funder to be bound by funding terms which included Court approval of the funding commission rate as a precondition to the making of the proposed orders had the benefit of avoiding any arguments as to the Court's power to interfere with funding agreements and as to the appropriateness of doing so.[27]

Floor condition that no class member worse off

33. The Full Court said that a second safeguard contained in the proposed orders was the floor condition that no class member could be worse off under the orders than he or she would have been if such orders had not been made. The inclusion of this condition was regarded as overcoming the Respondent's argument that a common fund order would probably result in the Funder receiving substantially more money and all class members receiving substantially less money, than if a funding equalisation order were made.[28]

Class member notification of orders before opt out choice made

34. The third safeguard was that, before class members were required to decide whether to opt out of the proceeding, they would be notified of the proposed orders and the fact that a reasonable funding commission at a Court-approved rate would be deducted from any settlement or judgment moneys received. The Full Court said that the benefit of early notification was that it would allow any class members who had concerns about this to opt out of the proceeding and bring their own case with or without other funding arrangements. In addition, the Full Court considered that early notification of possible deductions was fairer to Unfunded Class Members than informing them as part of settlement approval.[29]

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[26] Above, n 1, at [83].
[27] Above, n 1, at [92]-[96].
[28] Above, n 1, at [12]; [102].
[29] Above, n 1, at [13]; [109]-[112]. The Full Court dealt with a number of further arguments by the Respondent that opt out would not cure the detriment which it claimed would be caused to class members by the proposed orders at [113]-[125].

Likelihood of a funding equalisation order

35. The Full Court not only rejected the Respondent's argument that a funding equalisation order was to be preferred but rejected the argument that it was likely that the Court would make such an order in the proceeding at the appropriate time. The Full Court said that a funding equalisation order was just one method for achieving equality of treatment between class members, and that whether a funding equalisation order, a common fund order or some other order directed to achieving equality of treatment was appropriate depended upon the particular circumstances of the case and the position adopted by the parties.[30] The Full Court referred to the cases in which funding equalisation orders and common fund orders had been made to demonstrate this point.[31]

36. The Respondent claimed that the two decisions in which the Court had made common fund orders to achieve equality of treatment between class members, namely, *Pathway Investments Pty Ltd v National Australia Bank (No 3)* ("**Pathway**")[32] and *Farey v National Australia Bank Ltd* ("**Farey**"),[33] had been put in doubt because of the analysis in *Modtech Engineering Pty Limited v GPT Management Holdings Limited* ("**Modtech**')[34] and *Blairgowrie Trading Ltd v Allco Finance Group Ltd (Receivers and Managers Appointed) (in liq)* ("**Blairgowrie**")[35] where the Courts had refused to make common fund orders.[36]

37. However, while the Full Court accepted that the facts in *Pathway* and *Farey* were not analogous to the facts of the case before it and that these two decisions had little value as precedents,[37] the Full Court rejected, for a number of reasons, the claim that the orders made in these cases were in doubt. In particular, the Full Court said that the facts in *Modtech* and *Blairgowrie* were distinguishable from the facts in *Pathway* and *Farey* and were also distinguishable from the facts of the case before it and went on to explain the critical differences.[38]

38. The Full Court, however, did note that there was an important similarity between *Blairgowrie* and the case before it in that, in both cases, Court approval of a funding commission rate was sought at an early stage of the proceeding. In *Blairgowrie*, Wigney J's principal concern had related to the difficulty of fixing a rate at a stage of the proceeding when the reasonableness of the rate was not known but the Full Court was satisfied that the proposed orders addressed this concern by providing for

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[30] Above, n 1, at [126]-[129].
[31] Above, n 1, at [130]-[134].
[32] [2012] VSC 625.
[33] [2014] FCA 1242.
[34] [2013] FCA 626.
[35] [2015] FCA 811; (2015) 325 ALR 539. A summary of the decision in *Blairgowrie* can be found in K Ottesen, "*'Common fund' order refused at an early stage of a class action brought under Pt IVA of the Federal Court of Australia Act 1976 (Cth)*", 31 August 2015.
[36] Above, n 1, at [135].
[37] Above, n 1, at [136].
[38] Above, n 1, at [137]-[145].

Court approval of the rate at a later time when the Court had better information available to it.[39]

39. In *Blairgowrie*, Wigney J had said that it could not be assumed that there would be a common fund created from which the applicants in that case could recover the costs and expenses incurred by them in getting in the fund because a number of different outcomes were possible and not all of them would lead to the creation of a fund, let alone a 'common fund'.[40] The Full Court disagreed with Wigney J's view of the likelihood of a common fund being created, saying as follows:

> *"Funding arrangements like those in the present case are a common enterprise between the applicant and funded class members and the litigation funder. In consideration of the funder agreeing to pay the legal costs of the proceeding and to meet any orders for adverse costs or security for costs, the applicant and funded class members pool their promises to pay a percentage funding commission from any settlement or judgment, doing so for the common purpose of securing legal services for the benefit of the class as a whole… In our view, if the present case is successful in any substantial way, it is likely to lead to the payment of monies which may be treated as a common fund created by the applicant and funded class members for the common benefit of all class members."* [41]

Power to make the orders

40. Despite the Respondent's argument that the Court lacked the power to make the proposed orders, the Full Court was satisfied that the proposed orders were within power and were appropriate to ensure that justice was done in the proceeding pursuant to ss 33ZF and 23 of the FCA Act.[42]

41. The Full Court examined what the authorities had said about the power of the Court to make orders under s 33ZF of the FCA Act and the meaning to be given to the expressions "necessary to ensure that justice is done" and "appropriate … to ensure that justice is done"[43] and said that, in context, there was less of a difference between the two expressions than might first appear. The Full Court further said that "necessary" identified a connection between the proposed order and an identified purpose as to which the Court had to be satisfied before making an order and that the expression "necessary to ensure that justice is done" had shades of meaning and allowed for degrees of comparisons and, in context, was not to be given a narrow construction.[44] The Full Court went on to say:

> *"The requirement that a proposed order be 'necessary to ensure that justice is done in the proceeding' does not require that the Court be satisfied that*

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[39] Above, n 1, at [146]-[147].
[40] Above, n 35, at [144]-[153].
[41] Above, n 1, at [149].
[42] Above, n 1, at [7].
[43] Above, n 1, at [160]-[164].
[44] Above, n 1, at [165].

unless the order is made the administration of justice will collapse or that justice in the proceeding will not be 'ensured' in the sense of being certain. Section 33ZF provides a wide power directed at enabling the Court to make orders to deal with the novel problems that might arise through a new statutory procedure for representative proceedings, and the expression 'necessary to ensure that justice is done' requires that the proposed order be reasonably adapted to the purpose of seeking or obtaining justice in the proceeding."[45]

42. The Full Court, however, found that it did not need to further consider the ambit of "necessary" as the Applicant was not claiming that the orders were at that time "necessary" but was instead claiming that they were "appropriate ... to ensure that justice is done".[46]

43. The Full Court then said that the proposed orders were appropriate to ensure that justice was done in the proceeding for the following reasons:

- Prior to deciding whether to opt out of the proceeding, class members would be properly notified of the requirement to pay a reasonable Court-approved funding commission out of any settlement or judgment moneys.

- It was in the interests of class members that there be Court scrutiny of the funding terms and Court approval of the funding commission rate.

- It was likely that Court approval would result in a lower funding commission rate for the Applicant and the Funded Class Members and a lower deduction for the Unfunded Class Members than under a funding equalisation order.

- For the reasons already expressed in the judgment, the proposed orders would achieve equality of treatment between class members and this would provide a more secure foundation for the funding of the proceeding.

- The proposed orders would not be detrimental to class members because the Court was not fixing the commission rate and because there was the inclusion of a condition that class members not be worse off.

- The proposed orders would result in a reduction in the potential for conflicts of interest between Funded Class Members and Unfunded Class Members and between the Applicant's solicitors and Unfunded Class Members and would be of benefit to both the Funded Class Members and the Unfunded Class Members in the manner already set out in the judgment.[47]

44. Accordingly, the Full Court concluded that the power under s 33ZF was enlivened; that it was appropriate to exercise that power; and that there was no discretionary

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[45] Above, n 1, at [165].
[46] Above, n 1, at [166].
[47] Above, n 1, at [167].

reason for not exercising that power. The Full Court added that similar observations could be made about s 23 of the FCA Act.[48]

Policy considerations

45. Although the Full Court's decision was based on the interests of justice in the proceeding rather than on broader policy considerations, the Full Court said that a common fund approach to litigation funding charges and legal costs was consistent with the aims of Pt IVA of the FCA.[49] The Full Court came to this conclusion after examining the aims of Pt IVA and the manner in which representative proceedings were actually conducted. The critical points made by the Full Court can be summarised as follows:

    - The central aims of the Pt IVA regime included enhancing access to justice and increasing the efficient use of judicial resources by allowing a common, binding decision to be made in one proceeding, instead of in multiple proceedings.

    - The legislature had chosen an opt out representative procedure over an opt in representative procedure on grounds of equity and efficiency because the former ensured greater access to justice.

    - The costs and risks associated with representative proceedings had placed such litigation beyond the resources of ordinary, and even most wealthy, Australians. These costs and risks posed a serious obstacle to the enhancement of access to justice envisaged by the legislature.

    - Litigation funders had stepped in to fill the gap to facilitate access to justice.

    - Litigation funders were generally only prepared to fund shareholder class actions where they were 'closed class' representative proceedings (i.e. where the claimants had entered into a litigation funding agreement) although the practice had developed of 'opening' the class definition for a short period of time to bind potential claimants to any settlement or judgment.

    - Even funded open class representative proceedings generally did not continue as such but were converted into what were, in effect, closed class proceedings.

    - The growth in closed class representative proceedings had given rise to a number of significant problems:

        - a reduced level of access to justice;
        - the creation of a barrier to settlement;

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[48] Above, n 1, at [168]. Other arguments were also raised by the Respondent on the question of power. These were addressed by the Full Court at [169]-[175].
[49] Above, n 1, at [14];[66];[176].

  - a greater incidence of competing class actions in relation to the same wrong; and
  - a greater potential for conflicts of interest.

- These problems had led to commentators and law reform bodies favouring a common fund approach in funded representative proceedings.[50]

46. The Full Court then concluded as follows:

> "*In our view the proposed orders have the additional benefit that they will enhance access to justice by encouraging open class representative proceedings. If litigation funders are permitted to charge a commercially realistic but reasonable percentage funding commission to the whole class it is less likely that funders will seek to bring class actions limited to those persons who have signed a funding agreement. The encouragement of open class representative proceedings should reduce the potential for conflicts of interest between funded registered class members and unfunded class members and between the solicitors for the applicant and unfunded non-client class members. Open class proceedings will also act to inhibit competing class actions and avoid the multiplicity of actions which they represent. Competing class actions can cause significant delay, increased costs and wastage of the resources of the parties and the courts. … [T]his is not a factor in the present case but it may be in other cases*".[51]

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[50] Above, n 1, at [177]-[204].
[51] Above, n 1, at [205]. A summary also appears at [14].