

When Pragmatism Leads to Unintended Consequences: A Critique of Australia's Unique Closed Class Regime

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In an effort to ensure access to justice, Australian courts have fashioned a unique hybrid opt in-opt out process known as “closed classes.” The rationale that underlies closed classes is to prevent free-riding that may undercut the position of funders and class action law firms reliant upon entering into agreements with a critical mass of class members. However, multiple closed classes also pose problems for respondents seeking the comfort of finality. To secure settlement and thus ultimately benefit participating class members, Australian courts have formulated a procedure whereby the closed class is opened and nonparticipating class members are invited to either register their claims or opt out so that thereafter those who do not register and those who opt out are effectively precluded by res judicata from making further related claims. We argue that Australian courts’ support of closed classes, while driven by pragmatism, has produced unintended consequences. Many relate to the ethical dilemmas faced by class action law firms and litigation funders seeking to advance the interests of participating class members over and above those of nonparticipating class members. The Full Federal Court has recently approved an alternative common fund approach. However, questions remain as to whether Australian courts are appropriately equipped to measure and compare the alternative transaction costs associated with the current and proposed approach, and whether they are appropriately equipped to determine the commercial rectitude and fairness of litigation funding agreements.

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INTRODUCTION

Consistent with class action regimes elsewhere, the aims of Australia's class action regimes¹ are to enhance access to justice and to promote judicial efficiency by leveraging the economies of scale derived from aggregating common claims.² However, as a result of concerns related to a flood of U.S.-style litigation,³ Australia's regimes were established with a number of limitations, including a focus on compensating identifiable claimholders rather than on broader regulatory deterrence,⁴ as well as an absence of any sustainable funding regime to enable claimholders to instigate proceedings. Incentives for private enforcement that are present in other regimes, such as attorney contingency fees and respite from cost-shifting rules, were also eschewed.

Consequently, despite an initial flurry of activity, prior to the emergence of commercial litigation funding, Australian class actions were in decline.⁵ Aligning with Professor Brian Fitzpatrick's position in this issue of *Theoretical Inquiries in Law* regarding the potential for litigation funding to strengthen the viability of U.S. class proceedings,⁶ the advent of commercial litigation funding in Australia re-enlivened what appeared to be a dying regime. Approximately half of all class actions filed in the Federal Court of Australia in the past six years are now supported by commercial litigation funding.⁷ Australian courts are well aware that insofar as commercial litigation funders do support class actions, they facilitate access to collective redress which would otherwise be

1 *Federal Court of Australia Act 1976* (Cth) pt. IVA (Austl.); *Civil Procedure Act 2005* (NSW) pt. 10 (Austl.); *Supreme Court Act 1986* (Vic) pt. 4A (Austl.).

2 AUSTRALIAN LAW REFORM COMMISSION, GROUPED PROCEEDINGS IN THE FEDERAL COURT, REPORT NO. 46, at 8-9 (1988) (Austl.).

3 Commonwealth, *Parliamentary Debates*, House of Representatives, 26 November 1991, 3284 (Peter Costello) (Austl.).

4 *Cy-près* remedies are explicitly absent from all Australian class action regimes. See Jeff Berryman & Robyn Carroll, *Cy-près as a Class Action Remedy — Justly Maligned or Just Misunderstood?*, in PRIVATE LAW: KEY ENCOUNTERS WITH PUBLIC LAW 320, 321-22 (Kit Barker & Darryn Jenson eds., 2013).

5 Vince Morabito, *An Empirical Study of Australia's Class Action Regimes*, Fourth Report: Facts and Figures on Twenty-Four Years of Class Actions in Australia 6 tbl.1 (2016), <https://ssrn.com/abstract=2815777>.

6 Brian T. Fitzpatrick, *Can and Should the New Third-Party Litigation Financing Come to Class Actions?*, 19 THEORETICAL INQUIRIES L. 109 (2018).

7 Morabito, *supra* note 5, at 8.

very limited.⁸ Consequently, overall, decisions about commercial litigation funding have been favorable.⁹ In parallel, regulatory policy towards litigation funding has been liberal.¹⁰ Litigation funding of class actions has therefore grown over the past ten years and more litigation funders have entered the Australian class action market, including a number of offshore funders.¹¹

The decision of the Full Federal Court in *Money Max Int Pty Ltd (Trustee) v QBE Insurance Group Ltd* in October 2016, approving a common fund approach to litigation funder commissions, may lead to further growth in commercially funded class actions. However, as yet it remains unclear whether the decision's proposed judicial control of commissions associated with common fund orders will prove to be a double-edged sword for litigation financiers.

This Article explores how Australian courts have responded to the emergence of litigation financing in class actions. It argues that until the *Money Max* decision the approach of Australian courts had been pragmatic and ad hoc rather than principled and considered. As detailed below at Parts I and III, this pragmatic approach initially comprised the authorization of closed classes, defined by members' entry into litigation funding agreements as well as common harm. Later on, to ensure finality and secure settlement, Australian courts began opening these closed classes so that unfunded class members would also be bound by class settlement. We argue that this created a number of unforeseen problems, including a proliferation of competing class actions and complex conflicts of interest for class law firms party to litigation financing arrangements.

In part, the decision in *Money Max* aims to ameliorate some of these problems. The Article considers how a common fund approach might minimize

8 *E.g.*, *Money Max Int Pty Ltd. (Trustee) v QBE Ins. Grp. Ltd.* (2016) 245 FCR 191 [176-84] (Austl.); *Newstart 123 Pty Ltd. v Billabong Int'l Ltd.* [2016] FCA 1194 [51] per Beach J (Austl.); *Blairgowrie Trading Ltd. v Allco Fin. Grp. Ltd. (Recs & Mgrs Apptd) (in Liq)* (2015) 325 ALR 539 [20] per Wigney J (Austl.).

9 *E.g.*, *Money Max Int* (2016) 245 FCR 191 (approving a common fund order for an aggregate litigation funding commission); *Int'l Litig. Partners Pte Ltd. v Chameleon Mining NL* (2012) 246 CLR 455 (Austl.) (finding that litigation funders are not required to hold financial services licenses); *Jeffery & Katauskas Pty Ltd. v SST Consulting Pty Ltd.* (2009) 239 CLR 75 (Austl.) (finding that it was not an abuse of process if a funder failed to provide a claimholder with an indemnity for adverse costs); *Campbell's Cash & Carry Pty Ltd. v Fostif Pty Ltd.* (2006) 229 CLR 386 (Austl.) (finding that litigation funding of class actions is not per se an abuse of process).

10 2 AUSTL. PRODUCTIVITY COMM'N, ACCESS TO JUSTICE ARRANGEMENTS INQUIRY REPORT 608 (2014).

11 *Id.* at 609-10.

access to justice and ethical concerns posed by closed classes. It also considers the difficulties that future courts will face as a result of the common fund approach in determining the reasonableness and fairness of litigation funding arrangements. The Article commences at Part I by examining what is meant by closed classes, and at Part II goes on to consider whether closed classes led to greater numbers of competing class actions, as claimed by the Full Federal Court in *Money Max*¹² as well as a number of scholars.¹³ At Part III we examine how courts manipulated class composition for the purposes of settlement by employing opening and reclosing mechanisms, thus depriving nonregistered class members of the benefits of class settlement. The potential for the common fund approach to address some of the problems we identify with closed classes is considered at Part IV. We also consider the basis for future courts' determination of litigation funding commissions pursuant to the common fund orders outlined in *Money Max*, and whether it is likely that as a result of the decision funding commissions and other fees will fall. Additionally, we examine whether the decision is likely to lead to a reduction in competing class actions. We conclude by noting that Australia's approach to litigation funding of class actions is still unfolding, and that it remains shaped by incremental and largely pragmatic case-driven needs.

I. THE CLOSED CLASS

There are a number of options available when considering how to constitute the class when class proceedings are initiated. The proceedings may be instigated as an open class where class members are defined according to whether they have been affected by harm in a particular way. Alternatively, the proceedings may be instigated as a closed class where membership is defined not only according to whether a person has been affected by harm in a particular way, but also according to whether the person has entered into a retainer agreement with a particular class law firm and/or a funding agreement with a particular funder.¹⁴ If the class is constituted as a closed class and the person suffering harm qualifies as a participating class member, they are entitled to share in

12 *Money Max Int* (2016) 245 FCR [14, 205].

13 *E.g.*, Jarrah H. Ekstein, *Funding Open Classes Through Common Fund Applications*, 87 AUSTL. L.J. 331 (2013); Michael Legg, *Reconciling Litigation Funding and the Opt Out Group Definition in Federal Court of Australia Class Actions — The Need for a Legislative Common Fund Approach*, 30 CIV. JUST. Q. 52, 63 (2011).

14 *E.g.*, *City of Swan Hill v McGraw-Hill Co., Inc.* (2016) 112 ACSR 65 [8] per Wigney J (Austl.); *Blairgowrie* (2015) 325 ALR 539 [23] per Wigney J (Austl.);

the proceeds of the class action according to formulae that reflect customary principles of compensation (less any funding fees that have been agreed).¹⁵ However, in a closed class, if the person has suffered the relevant harm but not entered into agreements with the funder and/or class law firm, they do not qualify as a participating member, and they are not entitled to share in the class proceeds.¹⁶

The concept of closed classes preceded the arrival of litigation funders and was, in fact, implemented within months of the commencement of the federal regime.¹⁷ It has also been employed frequently by class law firms to enable the firms to maximize the number of class members liable for the risk premium associated with conditional fee arrangements, and to minimize free-riding by those not party to these arrangements.¹⁸ To be effective under Australian law, conditional fee agreements must be executed in writing.¹⁹ Otherwise, the risk premium is not recoverable from class members, who have little incentive to enter into an agreement to pay an uplift on professional fees, given that in opt-out proceedings they are entitled to a share of the claim

Rodriguez & Sons Pty Ltd. v Queensland Bulk Water Supply Authority [2014] NSWSC 1565 [23] per Garling J (Austl.).

- 15 On average, funders receive thirty-one percent of class proceeds. Vince Morabito & Vicki Waye, *Reining in Litigation Entrepreneurs: A New Zealand Proposal*, 323 NEW ZEALAND L. REV. 346 (2011).
- 16 *Matthews v SPI Elec. & SPI Elec. Pty Ltd. v Utility Serv. Corp. Ltd. (No. 13)* [2013] VSC 17, [20] per Forrest J (Austl.).
- 17 See Vince Morabito, *Class Actions Instituted only for the Benefit of the Clients of the Class Representative's Solicitors*, 29 SYDNEY L. REV. 5, 13-20 (2007).
- 18 VICKI WAYE, *TRADING IN LEGAL CLAIMS: LAW, POLICY & FUTURE DIRECTIONS IN AUSTRALIA, UK & US* § 8.5.2 (2008); Vince Morabito, *Contingency Fee Agreements with Represented Persons in Class Actions — An Undesirable Australian Phenomenon*, 31 COMMON L. WORLD REV. 201 (2005).
- 19 At the time, closed classes for those entering legal retainer agreements were being developed, the following provisions applied and required a written conditional fee agreement. See, e.g., *Legal Profession Act 1987* (NSW) ss 182, 184 (Austl.) (in force 1987-2004); *Legal Practice Act 1996* (Vic) ss 96, 98 (Austl.) (in force 1996-2004); *Queensland Law Society Act 1952* (Qld) ss 48IA-IC (Austl.) (in force 1952-2007). These provisions have since been repealed. The *Legal Profession Uniform Law* s 181 currently operating in New South Wales and Victoria lays down similar requirements: *Legal Profession Uniform Law Application Act 2014* (NSW) and *Legal Profession Uniform Law Application Act 2014* (Vic). Other jurisdictions continue to require a written conditional fee agreement. E.g., *Legal Profession Act 2007* (Qld), s 322 (2); *Legal Practitioners Act 1981* (SA), Sch 3, s 24 (2).

pool as long as they fall within the defined class.²⁰ For similar reasons, free-riding is also a concern for Australian funders,²¹ which, absent a court order, can only recover their commissions when class members enter into legally binding funding agreements.²²

However, free-riding was not the chief concern of the Full Federal Court in *Multiplex Funds Management Ltd. v P Dawson Nominees Pty Ltd.* when it decided that classes could be defined according to whether members had entered into funding agreements and/or retainer agreements.²³ Consistent with Australian courts' strictly legalistic tradition,²⁴ the Full Federal Court examined the statutory provisions regulating the constitution of the class and determined that entry into a funding agreement was not contrary to them.²⁵ On the Court's literal reading, the provisions allowed the relevant class to be constructed in any manner from among those suffering harm inflicted by the relevant respondents. Moreover, use of entry into a funding agreement as a membership criterion did not prevent any person meeting that criterion from opting out of the proceedings. In other words, the Court approached the task of interpretation on the basis that what was not expressly prohibited was permitted. Policy matters, including the possible proliferation of class actions, and potential conflicts of interest that these arrangements might pose between the class law firm and non-funded class members were explicitly discounted as significant considerations.²⁶ This latter position may have rested on the basis that, even without closed classes, competing class actions were already known in Australia.²⁷

20 WAYE, *supra* note 18, § 8.5.2.

21 *Id.*

22 *Blairgowrie Trading Ltd. v Allco Fin. Grp. Ltd.* (Recs & Mgrs Apptd) (in Liq) (2015) 325 ALR 539 (Austl.).

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

24 Australia's traditional deference to parliamentary supremacy and ministerial responsibility has created a judicial discourse that tends to sublimate policy within a formalistic approach to statutory interpretation and common law development. DAVID SOLOMON, *THE POLITICAL IMPACT OF THE HIGH COURT 184-86* (1992); LESLIE ZINES, *THE HIGH COURT AND THE CONSTITUTION 606* (2008).

25 *Federal Court of Australia Act* (1976) ss 33C(1), 33N (Austl.).

26 *See Multiplex Funds*, 164 FCR at [35] per Lindgren J; *id.* at [118] per Jacobson J (with whom French J agreed).

27 *E.g., Johnson Tiles Pty Ltd. v Esso Austl.* [1999] FCA 56 (Austl.).

II. MULTIPLE CLASSES

At the time that *Multiplex* was decided, closed classes appeared to be advantageous to class law firms and funders seeking to encourage as many potential members as possible to enter into tripartite retainer and funding agreements, on the basis that the members would otherwise be precluded from participating in the fruits of the class action. Nonetheless, closed classes remain problematic for respondents, and may lead to unnecessary duplication of effort and the waste of court resources.

As noted earlier, competing class actions are not solely associated with closed classes. Nonetheless, many argue that closed classes make competing class actions more likely.²⁸ We explore relevant empirical data collected by the second-named author later in the Article at Section IV.C. Here we simply note that approximately fifteen percent of all class actions filed in Australia were competing class actions,²⁹ and that since *Multiplex*, the number of competing class actions has increased from one every fourteen months to one every eight months.

From the perspective of either claimholders or respondents, economies of scale are clearly one of the major benefits of class actions. On the face of it, these scale efficiencies are undercut where multiple class actions proliferate. Dealing with different sets of pleadings, discovery, evidence, different litigation tactics and different settlement expectations not only makes the task of defending themselves more complex for respondents, but because they are dealing with multiple class law firms subject to various financing arrangements, it also makes it harder for respondents to settle.³⁰ Inevitably, by duplicating effort, competing class actions also increase the transaction costs associated with overall collective redress. The prospect of a considerable number of nonparticipating class members not bound by any judgment or settlement agreed to by lead plaintiffs makes it difficult for respondents to assess the ultimate scope of their liability, and consequently also adds to the difficulty of determining whether to settle with participating class members. This latter aspect is discussed in further detail in Part III below.

28 *E.g.*, Samuel Issacharoff, *Litigation Funding and the Problem of Agency Cost in Representative Actions*, 63 DEPAUL L. REV. 561, 572-73 (2013) (noting that the closed class encourages a secondary market in open classes seeking to piggyback off the efforts of the funded proceedings); Legg, *supra* note 13, at 61-62.

29 *See* Morabito, *supra* note 5, at 18.

30 *Smith v Austl. Executor Trustees Ltd.* [2016] NSWSC 17, [43] per Ball J (Austl.) (noting the requirement that each class law firm and set of lead plaintiffs reach a common position before settlement is feasible).

Since the *Multiplex* decision a number of class actions arising out of the same harm but involving different sets of class law firms (sometimes but not always funded) have been initiated. Examples include: *Smith v Australian Executor Trustees Ltd.*;³¹ *Creighton v Australian Executor Trustees Ltd.*,³² where the Court ordered the competing actions to be jointly tried and made provision for members of each overlapping class to choose which of the proceedings they wished to join (if any); *Haditichi v Nufarm Ltd.*,³³ where the Court consolidated the competing proceedings and granted leave to the two competing law firms to jointly represent the consolidated class and manage the class proceedings through a litigation committee; *Hobbs Anderson Investments Pty Ltd. v OZ Minerals*,³⁴ where the Court did not formally consider the issue of competing class actions; and *Kirby v Centro Properties Ltd.*,³⁵ where the Court proposed but ultimately failed to implement a litigation committee to govern the competing class actions, and so the actions, while tried jointly, continued to run in parallel with each other.

It appears that the Australian judiciary are more comfortable dealing with competing class actions on an ad hoc case by case basis.³⁶ The new Practice Note governing class actions in the Federal Court that was released in October 2016, for example, still fails to address competing class actions.³⁷ Similarly, there is little guidance to be found in the New South Wales Supreme Court Practice Notes³⁸

31 *Smith* [2016] NSWSC [43].

32 *Creighton v Austl. Executor Trustees Ltd.* [2015] FCA 1137 (Austl.).

33 *Haditichi v Nufarm Ltd.* (Unreported, Supreme Court of NSW, Middleton J, 9 August 2011) (Austl.), cited in LAW COUNCIL OF AUSTRALIA, FEDERAL COURT OF AUSTRALIA: CASE MANAGEMENT HANDBOOK 13.128 (2014) (Austl.); see also Vince Morabito, *Clashing Classes Down Under-Evaluating Australia's Competing Class Actions Through Empirical and Comparative Perspectives*, 27 CONN. J. INT'L L. 245, 276-77 (2012).

34 *Hobbs Anderson Investments Pty Ltd. v OZ Minerals Ltd.* [2011] FCA 801 (Austl.).

35 *Kirby v Centro Properties Ltd.* (2008) 253 ALR 65 (Austl.).

36 LAW COUNCIL OF AUSTRALIA, FEDERAL COURT OF AUSTRALIA: CASE MANAGEMENT HANDBOOK 13.121 (2014) (Austl.); Morabito, *supra* note 33, at 317-18.

37 *Draft Practice Notes and Consultation*, FED. COURT OF AUSTRALIA (2016), <http://www.fedcourt.gov.au/law-and-practice/national-court-framework/practice-notes-consultation>.

38 *Practice Note SC Gen 17 — Supreme Court Representative Proceedings*, SUPREME COURT OF NEW SOUTH WALES (2016), http://www.lawlink.nsw.gov.au/practice_notes/nswsc_pc.nsf/a15f50afb1aa22a9ca2570ed000a2b08/ed124ca1e3ce82aeca257d32001f9fe6?OpenDocument.

or the Victorian Supreme Court Practice Notes.³⁹ The case by case approach stems from a number of factors, including: (1) Australia's lack of a certification process such that class action procedure is assumed to be appropriate for properly constituted proceedings unless the court is persuaded to the contrary;⁴⁰ (2) the lack of any process to approve the class law firm and class counsel;⁴¹ and, historically at least, (3) the lack of any process to approve the financial arrangements underpinning the action.⁴²

Nevertheless, from the case law it can be gleaned that unlike their Canadian⁴³ and U.S. counterparts,⁴⁴ the Australian judiciary are reluctant to "choose a winner" and select one proceeding for trial and stay the other proceedings.⁴⁵ Despite the acknowledged difficulties faced by respondents and the implication for the overall costs of the proceedings, the instigation of multiple class

39 *Practice Note No. 10 of 2015 Conduct of Group Proceedings (Common Law Division)*, SUPREME COURT OF VICTORIA (Jan. 2015), <http://www.supremecourt.vic.gov.au/home/law+and+practice/practice+notes/practice+notes+archive/practice+note+no+10+of+2015+conduct+of+group+proceedings+common+law+division>.

40 *Federal Court of Australia Act 1976* (Cth) ss 33M-33N (Austl.); *Supreme Court Act 1986* (Vic) ss 33M-33N (Austl.); *Civil Procedure Act 2005* (NSW) ss 165-166 (Austl.). For an empirical study of the operation of this regime in the context of federal class actions, see Vince Morabito & Jane Caruana, *Can Class Action Regimes Operate Satisfactorily Without a Certification Device? Empirical Insights from the Federal Court of Australia*, 61 AM. J. COMP. L. 579 (2013).

41 *Federal Court of Australia Act 1976* (Cth) s 33T (Austl.); *Supreme Court Act 1986* (Vic) s 33T (Austl.); *Civil Procedure Act 2005* (NSW) s 171 (Austl.) (permitting class members to challenge the adequacy of class representatives (and as a corollary their legal representatives), without an upfront process for their approval). For an empirical study of the operation of the federal provision, see Vince Morabito, *Replacing Inadequate Class Representatives in Federal Class Actions: Quo Vadis?*, 38 U. NEW S. WALES L.J. 146 (2015).

42 Prior to *Money Max*, these matters tended to be presented as a *fait accompli* at settlement where there is limited objection from class members.

43 *E.g.*, Mancinelli v. Barrick Gold Corp., [2016] O.N.C.A. 571 (Can. Ont. C.A.); Locking v. Armtec Infrastructure, [2013] O.N.S.C. 331 (Can. Ont.); Tiboni v. Merck Frosst Can. Ltd., [2008] O.J. No. 2996 (S.C.J.), *aff'd* [2009] O.J. No. 821 (Div. Ct.) (Can.).

44 *E.g.*, *In re Countrywide Fin. Corp. Derivative Litig.*, 542 F. Supp. 2d 1160 (C.D. Cal. 2008); *Trent v. Dial Med. of Florida Inc.*, 33 F.3d 217, (3d Cir. 1994); *In re Oracle Sec. Litig.*, 131 F.R.D. 688, 132 F.R.D. 538 (N.D. Cal. 1990), 136 F.R.D. 639, (N.D. Cal. 1991).

45 Morabito, *supra* note 33, at 314-15.

actions by different class law firms is not, of itself, regarded as vexatious or oppressive.⁴⁶ Provided there is no double-dipping,⁴⁷ it seems to be accepted that offering potential class members a choice between class law firms and funding arrangements may be beneficial by reducing monopsony over representative and funding arrangements.⁴⁸ As a result, the typical judicial response to multiple proceedings is to order a joint trial and to issue ancillary orders with respect to joint submissions and matters designed to eliminate duplication of effort such as joint discovery.⁴⁹ So long as conflicting and/or overlapping judgments and settlements can be avoided, Australian courts are prepared to accommodate competing class actions.

III. OPENING AND CLOSING THE CLASS

In an open class proceeding, irrespective of whether they have consented to the proceedings, all persons who have a claim against the respondent(s) deriving from the matters giving rise to the harm set out in the parties' pleadings are bound by the settlement or judgment reached in respect of those matters. Class members may also be bound pursuant to issue estoppel⁵⁰ and, to the extent that it is reasonable for claims or defenses to have been raised by the lead plaintiff, by *Anshun* estoppel.⁵¹ This finality and, in particular, its extensive

46 *Smith v Austl. Executor Trustees Ltd.* [2016] NSWSC 17, [22-23] per Ball J (Austl.).

47 *See Oliver v Commonwealth Bank of Austl. (No. 2)* [2012] FCA 755 (Austl.) (where Perram J stayed proceedings initiated by lead plaintiffs who remained members of a class in earlier proceedings and did not opt out of those earlier proceedings).

48 *Smith* [2016] NSWSC at [43].

49 Morabito, *supra* note 33, at 314-15; *Special Report: Class Action Risk 2016*, ALLENS LINKLATERS (Aug. 19, 2016), <https://www.allens.com.au/pubs/class/papclass19aug16.htm>.

50 An issue estoppel is an issue of fact or law which is necessarily involved as a step in reaching the determination of the class proceeding. *See Timbercorp Fin. Pty Ltd. (in liq) v Collins* (2016) 339 ALR 11 [27] per French CJ, Kiefel, Keane, and Nettle JJ (Austl.).

51 *Anshun* estoppel relates to claims/defenses that ought to have been raised because they were so connected to the subject matter of the first proceeding as to make it unreasonable, in the context of the first proceeding, for the claim or issue not to have been made or raised in it. *See Timbercorp* (2016) 339 ALR at [27] per French CJ, Kiefel, Keane, and Nettle JJ. However, group members are not necessarily bound in respect of their individual claims, i.e., claims arising outside of the common harm alleged by the lead plaintiff. *See id.* at [58].

scope is of great benefit to respondents, and provides a significant incentive to settle the proceedings as quickly as possible.

The incentive to settle is further bolstered by “class closure” orders⁵² designed to identify and, as a corollary, limit the number of claimholders entitled to share in the class compensation pool. Regardless of whether a class action has been instigated as an open class proceeding, a class closure order requires class members to indicate whether they are interested in participating in a pending judgment or settlement by a deadline fixed in notices given to all class members. If the class members do not identify themselves in the prescribed manner, although technically they may remain class members,⁵³ they will not be entitled to share in the compensation agreed between the lead plaintiffs and respondent(s) or determined by the court. As a result of *res judicata*, if unregistered members remain in the class they will be bound by the terms of the settlement or judgment.

Such orders are made to enable the respondent(s) to accurately assess the size and scope of the overall claim against them, and are thus designed to facilitate settlement.⁵⁴ Identifying and limiting those entitled to share in the class settlement not only provides comfort to respondents, but also enables the class law firm to discharge its fiduciary obligations to class members in relation to any proposed compromise or settlement or in respect of the distribution of settlement funds.⁵⁵ Both of these factors are particularly important where the total number of class members and the concomitant global value of their claims are large.

There is a view that if, following extensive notification, class members are unwilling to come forward and identify themselves, then they are equally unlikely to come forward and seek to participate in the distribution of settlement

52 See, e.g., *Kelly v Willmott Forests Ltd. (in liq) (No. 4)* (2016) 112 ACSR 584 [34-50] per Murphy J (Austl.); *Lam v Rolls Royce PLC (No 3)* [2015] NSWSC 83 [17-18] per Beech-Jones J (Austl.); *Inabu Pty Ltd. v Leighton Holdings Ltd.* [2014] FCA 622 [17-22] per Jacobson J (Austl.); *Matthews v SPI Elec. Pty Ltd. & Ors (No. 13)* (2013) 39 VR 255 [23] per Forrest J (Austl.); *Mercieca v SPI Elec. Pty Ltd.* [2012] VSC 204 [24] per Emerton J (Austl.).

53 This depends on the form of the relevant order. Some orders remove all those who have not registered as members of the class, e.g., *Matthews*, (2013) 39 VR at [5], whereas other orders bar these class members from participating in the compensation pool, e.g., *Thomas v Powercor* [2011] VSC 614 [32] per Beach J (Austl.).

54 *Muswellbrook Shire Council v The Royal Bank of Scotland NV* [2016] FCA 819 [5-7] per Rares J (Austl.).

55 DAMIAN GRAVE ET AL., CLASS ACTIONS IN AUSTRALIA § 14.410 (2d ed. 2012).

funds at a later date.⁵⁶ Conversely, closing the class also inhibits free-riding by class members opting out of the settlement and entering into independent settlements with the respondent(s) without having to pay their share of the lead plaintiff's costs in mounting the class proceedings.⁵⁷ Given that respondent communication of offers to individual class members is not per se prohibited,⁵⁸ the disintegration of the economic basis for the class proceedings in this manner remains a threat.

Theoretically a class closure order is not required where the class is constituted as a closed class from the outset of proceedings and where class members are clearly identified according to whether they have entered retainer and litigation funding agreements.⁵⁹ However, a settlement or judgment in a closed class only binds members of the defined class, and thus leaves open the possibility that the respondent(s) may be faced with further claims from non-class members who have also suffered the same harm. Not knowing the scope of persons that may have claims against them, respondents may be more reluctant to settle the proceedings,⁶⁰ especially if the ratio of members of the closed class to all potential class members is low.⁶¹

Flowing from the imprimatur for instigating proceedings as a closed class, a further innovation has thus been introduced. Rather than simply settling the matter or proceeding to final judgment as a closed class, the class is opened for a short period of time and then closed again. During the period of time when the class is opened, class members are invited to register with the class law firm or funder by a stipulated deadline. Class members who fail to opt out or to register by the stipulated deadline are then excluded from participating in the distribution of the settlement/judgment funds.⁶²

56 *Lam v Rolls Royce PLC (No. 5)* [2016] NSWSC 1322 [15] per Beech-Jones J (Austl.).

57 *Perry v Powercor Australia Ltd.* [2012] VSC 113 [33] per Beach J (Austl.).

58 *Capic v Ford Motor Co. of Austl. Ltd.* [2016] FCA 1020 (Austl.).

59 See GRAVE ET AL., *supra* note 55, § 14.420.

60 *Money Max Int Pty Ltd. (Trustee) v QBE Ins. Grp. Ltd.* (2016) 245 FCR 191 [195] (Austl.).

61 Thus, in *Inabu Pty Ltd. v Leighton Holdings Ltd.* [2014] FCA 622, Opt Out Notice, appended to the judgment [13], the respondent reserved the right to withdraw from the settlement if the number of registered class members failed to reach a critical proportion of all class members. See also *Kelly v Willmott Forests Ltd. (in liq) (No. 4)* (2016) 112 ACSR 584 [139] per Murphy J (Austl.).

62 *Money Max Int* (2015) 245 FCR at [188]; *Blairgowrie Trading Ltd v Allco Fin. Grp. Ltd. (Recs & Mgrs Apptd) (in Liq)* (2015) 325 ALR 539 [28] per Wigney J (Austl.); *id.* per Jacobson J (Austl.); *Inabu Pty Ltd.* [2014] FCA at [16-17].

While designed to facilitate settlement and thus avoid very substantial litigation costs, this form of class manipulation poses a significant conflict of interests between the funder, the class law firm, the lead plaintiff, and non-funded class members. On the face of it, where a lead plaintiff seeks to settle the class action on the basis of a restriction upon the members of the class entitled to participate in settlement, there will be a clear conflict between the desire to settle the matter and obtain compensation and the interests of nonregistered class members who will not benefit unless the proceedings continue and generate a judgment in which they can share.⁶³ Similarly, there is a clear conflict between funders who benefit by a prompt settlement with respondent(s) and class members who are excluded from participation so that the settlement might be achieved. The longer the proceedings take to settle, the larger the funder's exposure to the risk of adverse costs, the greater the accumulation of class law firm fees, and the higher its cost of obtaining money to keep funding the proceedings. Of course, the funder is equally if not more motivated to maximize its return by not settling too cheaply, but that motivation is unlikely to extend to class members who have never registered with the class law firm or entered into funding agreements.

Absent a common fund order, the funder's commissions and hence its profits are only recoverable from members with funding agreements, and so while it has an incentive to maximize the compensation those members receive, it has little incentive to maximize non-funded members' compensation. Although the class law firm might appear to have more to gain by prolonging the proceedings, it too has a conflict where the continued payment of its fees and the minimization of its exposure to the risk of adverse costs are dependent on the willingness of the funder to persevere in the face of a settlement offer that excludes nonregistered and mainly non-funded class members. These conflicts are influenced by a number of factors including the way in which class members are recruited to closed classes, the adequacy of notices notifying class members about the registration process, equalization and other orders designed to level the playing field between funded and non-funded class members, and by the broad effects of issue estoppel and *Anshun* estoppel.

Short of a critical mass of class members willing to enter into the funding agreement, the funder will not be able to recoup the funds provided let alone profit from the proceedings.⁶⁴ Consequently, during what is colloquially

63 *Williams v FAI Sec. Pty Ltd. (No. 4)* (2000) 180 ALR 459 [21-23] per Goldberg J (Austl.).

64 *Blairgowrie* (2015) 325 ALR at [27] per Wigney J; see also John Walker et al., *Funding Criteria for Class Actions*, 32 U. NEW S. WALES L.J. 1036, 1044 (2009).

known as the “book building” phase⁶⁵ funders and class law firms must expend a great deal of time and resources to sign up class members. Often a minimum threshold of claimholders and claim value will apply as a condition for funding proceedings. Claimholders must be persuaded that unless they are prepared to enter a funding agreement the class action will not proceed and they will not receive any redress. In the context of current affairs, social media and claims canvassing, of necessity, this messaging must be easily digestible (and arguably simplistic). Accordingly, as well as highlighting the experience and reputation of the class law firm and funder, the messaging will usually emphasize that the class law firm and litigation funder wholly bear the litigation risk.⁶⁶ To obtain more detailed but usually not publicly available information, class members will generally be required to register their interest with the funder or class law firm.⁶⁷ Whatever reason class members have for not entering into the funding and retainer agreements, their view of the funding scheme will be largely based upon what has been promoted to them in the media and will therefore be incomplete. Comprehension of the issues related to the proceedings is unlikely to be based upon detailed understanding informed by independent legal advice.

Given that the purpose of the class opening and then closure orders is to deprive nonregistered claimholders of their right to redress, it is vitally important that the notices which are published to them apropos registration are easily understood. Ideally, the drafting of the notices also should take account of prior communications during the book building phase, and should allay any impression that failure to respond will leave class members in the same position that they currently occupy. It is also vitally important that

65 Camille Cameron, *Litigation as ‘Core Business’: Analyzing the Access to Justice and Regulatory Dimensions of Commercially Funded Class Actions in Australia*, in *CLASS ACTIONS IN CONTEXT: HOW ECONOMICS, POLITICS AND CULTURE SHAPE COLLECTIVE LITIGATION* 192 (Deborah R. Hensler et al. eds., 2016); Walker et al., *supra* note 64.

66 See, e.g., *Potential Class Action Against Developers in the ACT*, IMF BENTHAM (Aug. 23, 2016), <https://www.imf.com.au/cases/case-register-gst/gst-overview>; *Queensland Floods Class Action*, MAURICE BLACKBURN LAW., <https://www.mauriceblackburn.com.au/current-class-actions/queensland-floods-class-action/> (last visited July 13, 2017); *Home Insulation Program Class Action*, ACA LAW., <https://www.acaactions.com.au/hip-class-action> (last visited July 13, 2017).

67 This information is kept confidential for commercial reasons (i.e., to prevent competitor funders and class law firms from usurping the funder/class law firm’s competitive advantage) and for forensic reasons (i.e., to ensure that confidentiality and legal professional privilege over case material are maintained and to prevent respondent(s) from accessing case sensitive information).

notification be extensive, and that it incorporate the same degree of, if not more, coverage than that which occurred during the book building phase.⁶⁸

Initially these kinds of opt-out notices and class closure orders were made at an advanced stage of proceedings when the risks of failing to settle were clear.⁶⁹ However, in an effort to support prompter settlement, more recently courts have begun to issue these orders at an early stage.⁷⁰ Consequently, there is not much information available at that time to determine whether to opt out, register as a class member, or simply do nothing and lose any opportunity of recovery. Even where class closure occurs later, arguably, the notices themselves are difficult to understand and provide class members with limited guidance. The notices normally provide no information as to the probability of settlement, the range of likely settlement amounts, the amount of the funding commission, or how settlement funds are proposed to be distributed among class members. Although some reference may be made to the court's powers regarding recovery of class law firm fees and disbursements and to common fund or funding equalization orders, there is often little in the notices that provides unregistered class members with sufficient information to determine how these might affect the amount they might be entitled to recover should they choose to register.

However, the notices do state that by doing nothing, the unregistered class member

will not be entitled to receive any compensation from the Class Action . . . [the class member will] also be prevented from making a claim in respect of or relating to the subject matter of this Class Action against any or all of the Respondents by separate proceedings and from making a claim at a later stage of these proceedings.⁷¹

Insofar as this statement is concerned, problems can and do arise when the class action has not been as successful as anticipated and where, as a result,

68 *Matthews v SPI Elec. Pty Ltd. & Ors (No. 13)* (2013) 39 VR 255 [100] per Forrest J (Austl.).

69 *E.g., Winterford v Pfizer Austl. Pty Ltd.* [2012] FCA 1199 (Austl.); *Thomas v Powercor* [2011] VSC 614 (Austl.); *Johnson Tiles Pty Ltd. v Esso Austl. Pty Ltd. (No. 2)* [2003] VSC 212 (Austl.).

70 *E.g., Mitsub Pty Ltd. v McGraw-Hill Financial Inc. (No. 2)* [2016] FCA 1285 (Austl.); *Muswellbrook Shire Council v The Royal Bank of Scot. NV* [2016] FCA 819 (Austl.) (although in this case common issues of law and fact had been previously determined in earlier related proceedings); *Inabu Pty Ltd. v Leighton Holdings Ltd.* [2014] FCA 622 (Austl.); *Farey v Nat'l Austl. Bank* [2014] FCA 1242 (Austl.).

71 *Muswellbrook Shire* [2016] FCA at [34].

there is strong pressure on the class law firm and or funder to settle and halt the further escalation of costs. While mitigating their own exposure, it may be very tempting to settle on terms that do not necessarily reflect the best interests of all class members.⁷²

The complexity for class members faced with opt-out notices associated with class closure orders is aggravated where competing or overlapping closed and open class proceedings are heard together and where class members must effectively elect between each of the actions with limited guidance as to their respective advantages and disadvantages, or otherwise do nothing and lose rights to participate in class compensation. The notice provided to class members in *Mitsub Pty Limited v McGraw-Hill Financial Inc (No 2)* is illustrative.⁷³ This case involved three class proceedings against the securities rating agency Standard & Poor's in respect of various synthetic collateralized debt obligations (SCDOs). Adding to the complications, some of the claims in relation to the SCDOs were also the subject of earlier Federal Court proceedings in *City of Swan v McGraw-Hill Financial, Inc.*, and therefore barred from being advanced in these proceedings.⁷⁴ Membership in each of the proceedings was overlapping. One of the actions was self-funded and the other two were funded by Litigation Capital Partners LLP Pte Ltd. (a foreign-based funder). Of necessity, the opt-out notice was very long and explained the definition of each class, how members might register in each class, what might happen if they registered for one but not another, and what might happen if they did nothing. In some cases, members were required to elect between proceedings, and in others (depending on the type of SCDOs purchased) they could be members of two proceedings.

Clearly, there were a number of permutations and implications for whatever option or combination of options class members chose. To ensure client confidentiality as between the members of each of the various classes and to mitigate against the potential to use the notices as a vehicle for class member recruitment, the Court ordered that the notices be sent out by an independent solicitor. However, while that may have minimized competition between the different camps, it did little to assist class members' understanding of the

72 *E.g., Kelly v Willmott Forests Ltd. (in liq) (No. 4)* (2016) 112 ACSR 584 (Austl.) (where nonparticipating class members were unfairly bound by a settlement which prevented them from raising defenses against associated transactions); *Peterson v Merck Sharp & Dohme Pty Ltd* (No 6) [2013] FCA 477 (Austl.) (potentially strong class member claims were settled cheaply so that the lead plaintiff whose own claim failed might avoid adverse costs).

73 *Mitsub* [2016] FCA 1285.

74 *City of Swan v McGraw-Hill Fin., Inc.* (2014) 99 ACSR 280 (Austl.).

content of the notices. Moreover, even when class members referred to the respective class law firms for further information, it is unclear how objective each of the class law firms might have been in respect of the comparative merits of joining proceedings run by a competing camp. It would be almost impossible for the class law firms to act in a fiduciary role *vis-à-vis* class members in these circumstances.

This Part has thus shown that only minimal information is provided to class members during the recruitment phase and during the registration process when those who will share in the settlement or judgment proceeds are identified. The limited nature of the information provided exacerbates the conflicts of interest inherent in the relationship between nonregistered (and generally non-funded) class members and the class law firm, lead plaintiff and litigation funder when class closure mechanisms are applied to achieve settlement. Rather than dealing with these issues in a normative broad-based manner, Australian courts continue to approach them pragmatically on a case by case basis.

IV. APPROVAL OF A COMMON FUND APPROACH

According to the Full Federal Court in *Money Max*, the likelihood of conflicts of interest is diminished if the funder is permitted to charge all class members a court-approved funding commission. Although conceding that the need to identify class members and the scope of their claims will still require class closing orders, by approving a common fund the Court was of the view that its decision obviates the need to instigate proceedings as a closed class, to open the class, and then to close the class. Additionally, because the decision effectively negates any inequality between funded and unfunded claimholders concerning the financing of the proceedings, it also obviates the need for equalization orders or other orders such as those fashioned in *Pathway Investments Pty Ltd. v National Australia Bank Ltd. (No 3)*.⁷⁵ A further potential benefit may be the reduction in costs associated with the necessity to recruit as many class members as possible to funding and retainer agreements. Once a common fund order is issued, the funder and class law firm no longer need to enter into individual agreements with class members. In theory, this ought to lead to a reduction in funder project management charges and commissions. Additionally, the Court claimed that its approach would reduce wasteful competing class actions. Each of these projected benefits is considered below.

75 *Pathway Inv. Pty Ltd. v Nat'l Austl. Bank Ltd. (No. 3)* [2012] VSC 625 (Austl.).

A. Equalization Orders vs. Common Fund Orders at Settlement

Prior to the *Money Max* decision, the problem of free-riders and how to ensure that all class members contributed equally to the cost of financing the class action had been addressed in two alternative ways: (1) equalization orders; or (2) contribution orders analogous to a common fund approach. Under an equalization order, an amount is deducted from non-funded class members' compensation equal to the amount that would have been payable to the funder if funding agreements were in place, then redistributed pro rata among all class members.⁷⁶ Pursuant to the second option, unfunded class members have the relevant funding commission payable by funded class members pro rata deducted from their compensation and then paid to the funder.⁷⁷ While the first approach prevents the funder from receiving a windfall payment to which it would not otherwise be entitled, it does little apropos the funder's motivation to finance class proceedings if free-riding prevents the recruitment of a critical mass of class members. Either way the court effectively compels non-funded class members to pay an amount equal to the funding commission, but without undertaking a substantive investigation of the reasonableness or fairness of that commission.

While the courts' position regarding oversight of an arm's length bargain made directly between funded class members and the funder is understandable,⁷⁸ the lack of scrutiny regarding the rate of the funder's commission *vis-à-vis* non-funded class members is less justifiable. This is particularly problematic when, as noted above, the size of the funder's commission and other charges are generally not included within opt-out notices provided to class members. Judges have sometimes commented that there may be circumstances where the size and terms associated with a funder's commission might warrant judicial intervention.⁷⁹ However, given that up to forty-eight percent of recoveries for project fees and commissions have been previously approved,⁸⁰ it seems that prior to *Money Max* only egregious or unconscionable amounts would be disapproved. One advantage of the approach set out in *Money Max* is that it proposes to more carefully scrutinize the charges imposed on class members that have not engaged in commercial bargaining with the funder

76 *E.g.*, *Newstart 123 Pty Ltd. v Billabong Int'l Ltd.* [2016] FCA 1194 (Austl.); *Modtech Eng'g Pty Ltd. v GPT Mgmt. Holdings Ltd.* [2013] FCA 626 (Austl.).

77 *Pathway* [2012] VSC 625; *Farey v Nat'l Austl. Bank* [2014] FCA 1242 (Austl.).

78 *See also City of Swan v McGraw Hill Co., Inc.*, (2016) 112 ACSR 65 at [28-30] per Wigney J (Austl.).

79 *Id.* at [30]; *Pathway* [2012] VSC at [20] per Pagone J.

80 *City of Swan* (2016) 112 ACSR at [29] per Wigney J (Austl.).

and who are effectively compelled to pay the funder's fee to share in the class compensation pool.

However, many questions are raised by the decision regarding how this might be effectively implemented. Although it issued orders establishing a common fund in relation to class law firm fees and funder fees, the Full Federal Court declined to stipulate the funder's commission rate at such an early stage of the proceedings. The only indication of what might be regarded as appropriate were comments to the effect that the Court was not bound by the funding commission rates of 32.5%-35% already agreed to by a significant proportion of class members,⁸¹ and that the rate fixed by any future court was likely to be lower.⁸² The lead plaintiff suggested a rate of 30%, but the Court held that it was not possible to determine whether this was reasonable until the amount of the settlement or judgment was known (suggesting that future courts might adopt a sliding scale approach to funding commissions), where the quantum of adverse costs exposure was determinable, when legal costs were expended, when the number of registered class members was known, and where class member objections in respect of any proposed settlement might be heard.⁸³

From the judicial commentary in *Money Max*, it appears that future courts will be particularly focused upon fixing a rate of funder return which is commensurate with the risks of its investment. These risks are the funder (1) not being able to recoup its expenditure on legal fees, disbursements and other costs associated with managing the class action project; and (2) being made responsible for a successful respondent's costs. In theory, the proportion of these costs compared to the outcome stakes is linear, that is, legal costs should fall as claim size rises.⁸⁴ If that applies in the class action context, it

81 *Money Max Int Pty Ltd. (Trustee) v QBE Ins. Grp. Ltd.* (2016) 245 FCR 191 [28] (estimating that the ratio of relevant shares acquired by funded class members to relevant shares by unfunded class members fell within the range of twenty-five to forty-seven percent).

82 *Id.* at [11]. Furthermore, the Court expressed concern that in cases involving a very large quantum of compensation such as \$600,000,000, an aggregate funding commission of 33.75% would be "excessive or disproportionate to the risk taken by the Funder." *Id.* at [87].

83 *Id.* at [80].

84 *Id.* at [88] (citing Theodore Eisenberg & Geoffrey P Miller, *Attorney Fees in Class Action Settlements: An Empirical Study*, 1 J. EMPIRICAL LEGAL STUD. 27 (2004)).

follows that if return on investment is constant⁸⁵ then the funder's reward as a proportion of claim size should also decrease.

Limited data collected by the Australian Productivity Commission regarding personal injury claims in individual rather than representative proceedings supports the view that legal costs as a percentage of claim size fall as claim size rises.⁸⁶ Although comprehensive empirical data is unavailable, there is some limited evidence that this applies in the class action context too.⁸⁷ The data shows a ratio of legal fees to settlement sum for smaller claims lower than one million dollars of around fifty percent, whereas for larger claims of over fifty million dollars the ratio ranges from five to fifteen percent. If we applied these figures to a hypothetical class claim of a hundred million dollars, we might estimate that legal fees would cost a funder five to fifteen million dollars and that the funder might also be liable for security for costs and other expenses in the vicinity of five million dollars. If the funder estimated a hundred percent success rate, then consistent with typical venture capitalist expectations⁸⁸ it would anticipate a 2.5 x return on its investment or around twenty to twenty-five million dollars, supporting a funding commission between twenty-five and fifty percent. On the other hand, if the claim value was \$600,000,000 and legal fees were proportionally low at five percent of the claim or \$35,000,000, a 2.5 x return on investment would yield \$87,500,000 and would only support a funding commission of 14.6%. Of course, the anticipated return on investment will vary according to risk. If the funder's estimated success rate was fifty percent instead of a hundred percent, its return on investment would need to be much higher because risk would be increased by fifty percent apropos the respondent's adverse costs (which are likely to be equivalent to if not more than the lead plaintiff's costs), and the chances

85 Return on investment measures the amount of return on investment relative to the cost of the investment and is usually expressed as the following formula: $ROI = (\text{Gain from investment} - \text{cost of investment}) / \text{Cost of investment}$.

86 AUSTRALIAN PRODUCTIVITY ACCESS TO JUSTICE ARRANGEMENTS INQUIRY REPORT NO. 72, AT 120-22 (2014).

87 Michael Legg, *Mass Settlements in Australia*, in *RESOLVING MASS DISPUTES: ADR AND SETTLEMENT OF MASS CLAIMS* 172, 202 tbl.8.1 (Christopher Hodges & Astrid Stadler eds., 2013). In this instance, the author was not purporting to provide a systematic empirical study but a selection of settlements and outcomes, including the comparison between the resolution sum and the approved legal fees.

88 Robert S. Harris et al., *Private Equity Performance: What Do We Know?*, 69 J. FIN. 1851, 1860 tbl.II (2014) (calculating a 2.46 weighted average investment multiple for venture capital funds 1984-2008. Notably the weighted average investment multiple during the 1990s was 3.76 and in the 2000s, 1.67).

of recovery would be reduced by fifty percent. If the funder expects to lose \$65,000,000 ($\$30,000,000 \times 2 + \$5,000,000$) fifty percent of the time, then it will likely require a 7.5 x return on investment, which on a \$600,000,000 claim costing \$35,000,000 in legal fees supports a funding commission of around forty-four percent. Thus, litigation risk substantially moderates a funder's return on investment, and otherwise the funder's percentage of recoveries should fall as claim size increases.

However, these simplistic formulations do not take account of various factors — the time value of money, the funder's cost of capital, the funder's capacity to diversify its risk through its management of a portfolio of claims, the lumpy nature of its returns on investment, problems associated with sunk costs,⁸⁹ or the degree of monitoring and control exercised by the funder⁹⁰ — and so are very limited in their ability to determine the funder's risk exposure versus projected reward at the time the funder's obligations are incurred. Nonetheless, it appears that despite a willingness to fix funders' rates of return, so far Australian courts are very reluctant to take these matters into account,⁹¹ preferring instead to refer to funding commissions permitted in prior cases in Australia and elsewhere.⁹²

Apart from examining funding commissions that have been permitted but not heavily scrutinized in prior cases, there is little to assist future courts in determining what might be regarded as a reasonable return for a present-day funder. IMF Bentham Ltd., one of the few funders to make such data publicly available, claims an average 1.55 investment multiple over sixteen years of operations,⁹³ which is slightly lower than the 1.67 average weighted investment multiple for venture capital funds for the period 2000–2008 noted in the literature.⁹⁴ It is also significantly lower than the multipliers seen in Canadian and U.S. decisions regarding the appropriate contingency for class

89 Because litigation funding is non-recourse it is not easy to exit from a class proceeding, and sunk costs tend to quickly escalate once proceedings are commenced.

90 Counterintuitively, greater monitoring and control of the class action may lead to a higher required return. Sophie Manigart et al., *Determinants of Required Return in Venture Capital Investments: A Five-Country Study*, 17 J. BUS. VENTURING 291, 304 (2002).

91 *Blairgowrie Trading Ltd. v Allco Fin. Grp. Ltd. (Recs & Mgrs Apptd) (In Liq) (No 3)* (2017) 118 ACSR 614 [122] per Beach J (Austl.).

92 *Id.* at [125-38]; see also *Earglow Pty Ltd. v Newcrest Mining Ltd.* [2016] FCA 1433 [166-77] per Murphy J (Austl.).

93 IMF BENTHAM LTD., ANNUAL REPORT 1 (2016).

94 Harris et al., *supra* note 88. The actual average investment multiple rather than the weighted average for this period was 1.03. *Id.* at 1860 tbl.II.

action attorney fees. In her review of Canadian practice, for example, Jasminka Kalajdzic explains that Canadian courts generally approve attorney fees using a multiplier between 1 and 4 on base fees, so that attorneys often end up receiving around twenty-five to thirty percent of the common fund.⁹⁵ In the United States, the courts generally use the percentage method to determine attorney fees, but will also evaluate their reasonableness by checking the percentage result against a lodestar-multiplier calculation.⁹⁶ U.S. courts have also determined a presumptively acceptable multiplier range of 1-4,⁹⁷ but multipliers have tended to be higher in cases involving larger claims, with one study finding a mean multiplier of 6.20 for claims worth greater than a hundred million dollars.⁹⁸

On that basis, IMF's returns hardly seem rapacious, but how does one know whether they are fair and reasonable in the context of the specific proceeding before the court? While the court is required to identify the risk associated with failing to settle and proceeding to trial,⁹⁹ this is largely done through the lens of hindsight with the particular purpose of justifying the terms of settlement rather than as an *ex ante* estimate of risk and return. In *Money Max*, the Court acknowledged that litigation funders would be discomforted because of the onerous nature of their obligations compared with the uncertainty surrounding the size of their returns, but contended that the uncertainty would diminish as precedent approving funding commission charges built up over time. On a comparative note, the Court also remarked that the requirement of court approval for attorney contingency fees in the United States had not made U.S. attorneys reluctant to initiate class actions.¹⁰⁰ That may be so, but there is already a broad and deep body of jurisprudence governing the reasonableness of attorney fees in U.S. class actions, U.S. attorneys are not responsible for adverse costs, and arguably, they are better placed than funders to control and monitor the risks and rewards of class actions. Moreover, the Court did not explicitly refer to a series of Canadian decisions where litigation

95 Jasminka Kalajdzic, *The Engine That Drives: Fees, Costs and the Canadian Class Action*, in CLASS ACTIONS IN CONTEXT, *supra* note 65, at 245.

96 WILLIAM B. RUBENSTEIN, NEWBERG ON CLASS ACTIONS § 15.52 (5th ed. 2016).

97 *E.g.*, *Vizcaino v. Microsoft Corp.*, 290 F.3d 1043, 1051 (9th Cir. 2002); *Dyer v. Wells Fargo Bank, N.A.*, 303 F.R.D. 326, 334 (N.D. Cal. 2014).

98 Stuart J. Logan et al., *Attorney Fee Awards in Common Fund Class Actions*, 24 CLASS ACTION REP. 167, 170 (2003).

99 *E.g.*, *Newstart 123 Pty Ltd. v Billabong Int'l Ltd.* [2016] FCA 1194 at [13] per Beach J (Austl.); *Williams v FAI Sec. Pty Ltd. (No. 4)* (2000) 180 ALR 459 [190] per Goldberg J (Austl.).

100 *Money Max Int Pty Ltd. (Trustee) v QBE Ins. Grp. Ltd.* (2016) 245 FCR 191 [83] (Austl.).

funding agreements were submitted for court approval at the precertification stage of the proceedings so as to provide certainty to the funder, to the class action attorneys, to class members, and to respondents who were provided reassurance regarding their capacity to recoup legal costs in the event that the claim was successfully defended.¹⁰¹ Other commentators have certainly expressed the view that it would be preferable if the funding agreement was approved at the outset of proceedings.¹⁰²

Given the linear relationship between size of claim and percentage of recoveries outlined earlier, arguably it is insufficient to simply compare the percentage of recoveries between cases.¹⁰³ Hopefully, the courts will also look to the Canadian and U.S. jurisprudence to provide them with guidance as to the range of acceptable investment multipliers, noting that in Canada and the United States attorneys are not liable for adverse costs nor are they made responsible for providing security for costs. Furthermore, it would be useful to systematically collect more empirical data correlating the size of claims, legal fees and disbursements, security for costs, and time to disposition to gain a deeper understanding of risk factors governing litigation funders' investment in class proceedings.

B. Reduction in Funder Project Management Charges and Commissions

As we noted earlier, an enormous amount of resources is expended to recruit class members to class law firm retainers and funding agreements. Whether or not this will be avoided by dint of a common fund order and lead to reductions in funder charges is yet to be determined. Although there may be savings, given that pursuant to *Money Max* the size of the funder's commission will not be determined until settlement, to reduce uncertainty the class law firm and funder may still wish to attempt to sign up as many class members as possible to be in a position to choose whether to apply for a common fund order or to simply be rewarded on the basis of their intertwined *ex ante* agreements. If a sufficiently large number of class members can be recruited to funding agreements at a higher rate of commission than that which might

101 *E.g.*, *Stanway v. Wyeth Canada Inc.*, [2015] 3 W.W.R. 628 (Can. B.C.); *Musicians' Pension Fund of Can. (Trustee of) v. Kinross Gold Corp.*, 117 OR 3d 150, [2013] (Can.); *Smith v. Sino-Forest Corp.*, [2012] 216 A.C.W.S. (3d) 834 (Can. Ont.); *Dugal v. Manulife Fin. Corp.*, O.R. 3d 364, (Can.) [2011] (cited for another purpose in *Money Max* (2016) 245 FCR at [181]).

102 Ekstein, *supra* note 13; Legg, *supra* note 13, at 70.

103 However, that was the approach taken in *Blairgowrie Trading Ltd. v Allco Fin. Grp. Ltd. (Recs & Mgrs Apptd) (In Liq) (No 3)* (2017) 118 ACSR 614 [130-42] (Austl.).

be approved by the court, funders will be better off eschewing a common fund order. Furthermore, while the Court in *Money Max* made it clear that the commission set out in the litigation funding agreement is not determinative, if a large percentage of class members execute funding agreements, particularly members who are sophisticated and well resourced, future courts are likely to defer to their choices.¹⁰⁴ Lastly, it may be that future approval of a common fund application will be dependent upon the ratio of class members that a class law firm and funder have managed to recruit. Should a class law firm and funder not be able to recruit a minimum threshold of class members, the court may be reluctant to issue binding orders across the class.

Given that court-approved funding commissions in Australia are likely to be lower rather than higher than current typical fees, this may pose a significant conflict of interest for the class law firm that must be disclosed and carefully managed. The class law firm is a fiduciary for all class members, who will plainly be better off with lower rather than higher rates of funding commission, but perhaps not better off at all if litigation funders are unwilling to underwrite the class action unless a minimum number of class members are recruited into funding agreements at stipulated (and thus certain) rates of return. As the class law firm is dependent on the funder for payment of its fees, it will be difficult for it to provide independent advice to lead plaintiffs as to the benefits of seeking a common fund order versus continuing to recruit class members into potentially more expensive funding arrangements. The situation is made more complex because as yet there is a dearth of precedent determining the reasonableness of funder fees in the common fund context.

It remains to be seen, therefore, how this decision might affect funder and class law firm behavior. Up until this point, it would be fair to state that the funder-class law firm relationship is analogous to a joint venture, albeit the ultimate beneficiaries of their project are meant to be class members.¹⁰⁵ Moreover, the relationship is characterized by repeat transactions between the parties. It may be that as a result of *Money Max*, the comfortable nature of the relationship between some class law firms and funders will require more robust negotiation, and that class law firms will have to engage in more shopping around apropos funding terms on behalf of class members to demonstrate that they have fulfilled their fiduciary duty to their clients and to persuade the courts that, indeed, the funding commissions agreed represent arm's length terms.

104 *Money Max Int* (2016) 245 FCR at [80](a).

105 Vicki Waye & Vince Morabito, *Financial Arrangements with Litigation Funders and Law Firms in Australian Class Actions*, in *LITIGATION, COSTS, FUNDING AND BEHAVIOUR: IMPLICATIONS FOR THE LAW* 155 (Willem H. Van Boom ed., 2016).

In the absence of specific case examples, the prioritization between the factors relevant to fixing common fund commissions remains an open question. The Court in *Money Max* listed a number of factors likely to be relevant to fixing a court-approved funding commission, including the funding commission rate agreed to by sophisticated class members, the information provided to class members in relation to the funding fee, the broad parameters of funding commission rates in the market, litigation risk, the quantum of adverse costs, the size of the outcome stakes, and the amount of legal fees expended and class member objections.¹⁰⁶ Thus, if funders are sensitive to the conflicts facing the class law firm, it may be that the choice postulated earlier regarding signing up of members to funding agreements versus applying for a common fund order is rather narrow once the book building phase has passed and proceedings are instituted. Alternatively, to mitigate the class law firm's conflicts of interest it may be necessary to ensure that class members are provided with independent advice and representation regarding the common fund application. For similar reasons, the court is likely to appoint a contradictor when fixing the funder's fees at settlement.

C. Closed Classes vs. Opening Classes and Class Closure

According to the Court in *Money Max*, another significant advantage of the common fund regime compared with earlier practice is that class members will be informed that a Court-approved funding commission will be applied prior to class members being required to opt out.¹⁰⁷ However, because the actual funding fee will not be determined until settlement, it is not clear how this necessarily advances the interests of class members beyond what is already encapsulated in opt-out notices that are sent to class members when it is proposed to open a closed class and then close it again once any relevant registration date has expired. Where a funder is involved, the opt-out notices invariably state this fact.

One potential advantage of the *Money Max* approach is that the funder is effectively locked in to underwriting the proceedings and cannot extricate itself without an order of the court.¹⁰⁸ Moreover, the funder's obligations remain enforceable up until the effective termination date. From the court's perspective, this makes it less likely that the court will be "blackmailed" into approving a funding agreement at a time when it is difficult to fully ascertain litigation risk. Instead, the funder is required to commit to financing the

106 *Money Max Int* (2016) 245 FCR at [80].

107 *Id.* at [109].

108 *Id.* Annexure A, Cl, 13.

proceedings on the basis that it will receive recompense on what the court perceives to be fair and reasonable.

D. Reduction in Competing Class Actions

The Full Federal Court also contended that one of the chief policy benefits of approving a common fund approach to litigation financing was a reduction in closed classes and thus wasteful competing class actions. Using three-year periods starting from October 26, 2004, the second-named author found the following data with respect to the employment of closed classes in federal class actions:

- October 26, 2004 – October 25, 2007 — 62% of funded federal class actions
- October 26, 2007 – October 25, 2010 — 76% of funded federal class actions
- October 26, 2010 – October 25, 2013 — 68% of funded federal class actions
- October 26, 2013 – October 25, 2016 — 33% of funded federal class actions

A downward trend in the use of closed classes by litigation funders is thus evident. As a result, one is tempted to suggest that the scenario that the Full Federal Court hopes to see in the federal class action landscape in the future, through common fund orders, already exists to a substantial extent.

With respect to the issue of competing class actions, the Full Federal Court appeared to be of the view that a principal cause of competing class actions has been the filing of closed funded class actions followed by the filing of open funded class actions. As of the end of 2016, a total of thirty instances of competing class actions had taken place in Australia. In ten such instances, one or more of the competing class actions were funded. With respect to one of these instances, none of the competing class actions were filed in the Federal Court. In four of the remaining nine instances, the funded class actions were not the first class actions to be filed and, subject to one exception, they all employed closed classes. The exception concerns one set of competing class actions which included two funded class actions which were filed after an unfunded class action: one of the two funded proceedings employed a closed class device, whilst the other funded class action used an open class mechanism.

In two of the remaining five instances of competing class actions that saw the involvement of commercial litigation funders, funded open class proceedings were followed by unfunded open class proceedings. In the remaining three instances, funded closed class proceedings were followed by funded open class proceedings. These three sets of competing class actions all occurred in the first three years after the *Multiplex* ruling.

The brief summary provided above of competing class actions which encompassed funded class actions is sufficient to demonstrate that the apparent

public (and possibly judicial) perception of competing class actions arising as a result of funded closed class litigation followed by funded open class litigation is not accurate, at least not since 2010.

V. FURTHER IMPLICATIONS

As discussed earlier, up until *Money Max*, Australian courts took a laissez-faire approach to litigation funding rates. While funders must ensure that their agreements with class members comply with Australian consumer protection regulation,¹⁰⁹ no ceiling rates for funder commissions are fixed by regulation. However, post *Money Max*, what might be fair and reasonable for the purposes of a common fund order may also be taken up by the courts when considering whether the terms of the settlement overall are fair and reasonable or when deciding to issue an equalization order. Already, the leading judge in *Money Max* has determined that the reasonableness of funder commissions is subject to approval in the context of an application for an equalization order, holding that the Court is empowered to make approval of a settlement conditional upon a reduction in agreed funding commissions, if so warranted.¹¹⁰ Given that the Court in *Money Max* commented that it favored fees correlated with the size of the overall claim pool, this suggests that for larger claims this will lead to considerable downward pressure on litigation funder charges in the future regardless of whether a common fund order is sought.

The order proposed in *Money Max* proceeded on the basis that the commission rate would be a flat rate applicable on an equal basis for all registered class members. However, in the past it has been usual for funders in securities claims actions to discriminate between class members with large claims versus class members with small claims. Funder commissions often vary by as much as five percent.¹¹¹ This discrimination is justified on two grounds: (1) larger claims are less expensive to administer than a series of smaller claims; and (2) discounts are necessary to attract large institutional investors to the funding agreements underpinning the class proceedings in order to

109 *Corporations Regulations 2001* (Cth) regs 7.6.01AB(4)(d)(vii), (4)(e) (Austl.); see also *Nemeth v Austl. Litig. Funders Pty Ltd.* [2014] NSWCA 198 (Austl.).

110 *Earglow Pty Ltd. v Newcrest Mining Ltd.* [2016] FCA 1433 [134] per Murphy J (Austl.).

111 *Modtech Eng'g Pty Ltd. v GPT Mgmt. Holdings Ltd.* [2013] FCA 626 [20] per Gordon J (Austl.); *Blairgowrie Trading Ltd. v Allco Fin. Grp. Ltd. (Recs & Mgrs Apptd) (in Liq)* (2015) 325 ALR 539 [45] per Wigney J (Austl.).

make them commercially feasible.¹¹² Because it binds all class members, a common fund order precludes the need for differential treatment, as there is no further need to offer discounts to attract large players to agreements. Similarly, as the costs are spread out over all class members, it is more likely that greater economies of scale will reduce the significance of administering smaller claims.

Arguably, a flat rate funding fee is more consistent with general principles of compensation than a fee that fluctuates according to a class member's bargaining power. Nevertheless, in an application for an equalization order pursued in the *Earglow Pty Ltd. v Newcrest Mining Ltd.* securities class action, the Court approved funding rates that varied from twenty-six to thirty percent, depending on the amount of shares held by class members. The Court's chief focus in that case was upon the reasonableness of the aggregate return to the funder rather than the reasonableness of the differentiation between class members.

One matter that the *Money Max* decision leaves open is whether future courts will play a more active role in approving class law firms and funders. If the comparative advantages associated with closed classes diminish, this may lead to greater competition between funders and class action law firms to be the first to initiate proceedings, sign up a critical mass of class members, and secure a common fund order. Following the *Money Max* decision, IMF Bentham Ltd., Australia's largest class action funder, issued a press release stating that it did not believe that the decision would lead to a "race to the court door" to file class actions. Nonetheless, it conceded that competing open class actions were likely to remain and that, as a result of the common fund approach, future courts would be forced to choose between different funder and class law firm teams according to their combined experience, financial capacity and claimant support.¹¹³ Consequently, the courts' current approach to competing class actions is likely to be in need of revision. Courts of the future may well be forced to "pick a winner."

112 Andrew Watson & Michael Donnelly, *Financing Access to Justice: Third-Party Litigation Funding and Class Actions in Australia*, 55 CAN. BUS. L.J. 17, 31 (2014) (noting that in a large number of securities class actions institutional investors may constitute up to twenty percent of the total claim value and therefore without their support the claim will falter).

113 *Federal Court Makes First Common Fund Order*, IMF BENTHAM LTD., <http://www.imf.com.au/docs/default-source/site-documents/qbe-common-fund-order.pdf?sfvrsn=2> (last visited July 13, 2017).

CONCLUSION

Although litigation funding of collective redress is not unique to Australia, along with Canada and New Zealand, Australia is one of the few jurisdictions to have begun developing a body of jurisprudence that considers the impact of litigation funding upon class member interests, class action governance, and the efficacy of class proceedings. Reflecting Australia's overall permissive class action framework, the Australian approach has been both liberal and pragmatic. Regulation of litigation funding has been minimalistic, and up until the decision in *Money Max*, Australian courts have not examined the terms of litigation funding agreements in any depth. In the laissez-faire tradition, litigation funding agreements were viewed as a matter of private bargaining between those best placed to determine what lies in their respective interests. Absent public financing arrangements and as a result of constraints on class law firm self-funding, quite rightly litigation funding has been characterized as advantageous to class members whose claims would otherwise not be pursued. The fact that litigation funding imposes high transaction costs upon class members' recovery (on average thirty-one percent of recoveries¹¹⁴) has been regarded as fair and reasonable given the funder's risks of not being able to recoup investment and of being exposed to adverse costs. In light of these substantial risks, even where funder return has been almost fifty percent of recoveries the courts have not been persuaded that the return is unreasonable.

Funders also bear a substantive risk of not being able to recruit a sufficient number of class members to ensure an appropriate return on investment. During the evolutionary stages of litigation funding of class actions in Australia, this resulted in class law firms and funders seeking orders for "closed classes" defined according to the harm suffered as well as whether class members entered into funding agreements. Consistent with Australia's penchant for legal positivism and in line with the pragmatic view that litigation funding improves access to justice, Australian courts determined that if closed classes were not prohibited then they must be permitted. Initially, this stance appeared to lead to a proliferation of competing class actions, and raised difficulties as to how they might be managed which still have not been adequately resolved. However, gradually funders began uncoupling their recruitment efforts from the need to instigate proceedings as closed classes. Whether this was due to a realization that closed classes did not necessarily make recruiting of class members to funding agreements easier is unclear. From the funder's perspective, free-riding may not be such a significant issue if the funder's obligations are contingent upon the recruitment of a crucial mass

114 Morabito & Wayne, *supra* note 15, at 346.

of class members, and if the major reason for failure to participate is apathy rather than free-riding. The gradual decline in closed classes also matched the development of judicial efforts to level the playing field between funded and unfunded members through equalization and contribution orders. These orders, again a pragmatic response to the need to ensure an equal basis for class member recoveries, further ameliorated the free-riding threat (albeit without comprehensive and detailed investigation of funding commissions).

More importantly, however, the closed class posed significant conflicts of interests when at settlement, respondents seeking finality demanded class opening and closure orders that ring-fenced their liability. At the same time, because of broad principles of *res judicata*, issue estoppel and *Anshun* estoppel, such orders had a significant impact on the rights of nonparticipating class members.

Seen in this light, the development of a common fund approach to litigation funding is a further example of pragmatism prevailing in response to some of the problems (perceived and real) arising from closed classes and the conflicts of interest that they pose. Whether the conflicts will be mitigated or be replaced by new conflicts that arise when choices are made to commence as an open class, then seek a common fund order, or to commence as a closed class with attendant opening and closure orders, remains to be seen. Given the decline in closed classes, it seems unlikely that the decision will lead to a substantial fall in the number of competing class actions, which are certainly not monopolized by funders. Judicial scrutiny of funder commissions may lead to a decrease in transaction costs associated with class proceedings. At this stage, however, even though funder transaction costs appear high, they are relatively parsimonious compared with the return on investment enjoyed by attorneys in jurisdictions that permit contingency fees and compared with typical venture capitalist expectations. Consequently, it appears that despite almost fifteen years of funded class actions, Australian jurisprudence has yet to reach maturity, and that we will continue to see the processes underpinning Australia's unique hybrid opt in-opt out system unfold.