



WHITE PAPER

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Australian Law Reform Commission Releases Class Action and Litigation Funding Report

*Courts Empowered, More Action Needed on Shareholder Claims and
Contingency Fee for Class Action Lawyers to Increase Class Action Activity*

The Australian Law Reform Commission Class Action and Litigation Funding Report recommends:

- A further inquiry aimed at the substantive law employed in shareholder class actions.
- Legalization of contingency fees for lawyers in class actions, but subject to court approval and supervision.
- Greater powers for the supervision of litigation funding be given to the Federal Court, including being able to reject, vary, or amend the terms of litigation funding agreements.
- Greater powers for resolving competing class actions be given to the Federal Court and a single class action should be the preferred approach.

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OVERVIEW

The Australian Law Reform Commission (“ALRC”) released the report from its year-long inquiry into class actions and litigation funding on 24 January 2019.

The reference to the ALRC was a response to concerns that the social utility and legitimacy of the class action regime was being undermined because the interests of claimants, and society more generally, was taking a backseat to profit generation for lawyers and funders.

The concern is borne out by the ALRC’s finding that the median return to group members in funded matters was 51 percent, whereas in unfunded proceedings the median return was 85 percent of the settlement award.

Further, for all finalized shareholder claims between 2013–2018 the median percentage of the settlement used to pay (i) legal fees was 26 percent and (ii) litigation funding fees was 23 percent, with the result that the median percentage of a settlement that was paid to group members was 51 percent.

The ALRC’s recommendations make significant headway in wresting control of class actions from litigation funders and plaintiffs lawyers, and giving the court oversight and greater control so as to protect both group members and the court’s processes.

More still needs to be done in relation to shareholder class actions. The ALRC’s approach was to recommend a further review which should be undertaken. However, the ALRC’s recommendation in favour of allowing contingency fees for lawyers in class actions is a retrograde step that promises to increase class action activity.

SHAREHOLDER CLASS ACTIONS

During the conduct of the inquiry the ALRC found that a number of issues relating to the way in which the class action regime in Part IVA of the *Federal Court of Australia Act 1976* (Cth) was operating were confined largely to issues relating to shareholder claims. Moreover, shareholder class actions are the most common form of class action and are growing. The ALRC found that shareholder class actions constitute one-third of all federal court class actions, they are always funded,

they rarely go to trial, they commonly result in competing class actions, and as pointed out above, half of the recovery is consumed by transaction costs.

Some of these concerns are addressed by the ALRC making recommendations for procedural reforms aimed at regulating litigation funding, monitoring costs and managing competing class actions, which are discussed below. However, the ALRC also identified that there were a range of substantive legal issues that were significant class action drivers, in particular:

- The current lack of any need to prove any element of fault or intention, which raises whether the original requirement of “intentionally, recklessly or negligently” failing to comply with the listing rules should be reinstated.
- Uncertainty over the causation requirement and whether “market-based causation” or a presumption of reliance is sufficient or the law requires proof of individual reliance on the alleged misconduct.
- Uncertainty over the measure of loss.
- Lack of defences, such as due diligence, for the corporation.

There are also a range of economic issues such as the impact of shareholder class actions on the availability and pricing of directors’ and officers’ insurance.

The ALRC canvassed the arguments on both sides of the above issues but concluded that a further evidence-based review directed to the substantive law was warranted.

CLASS ACTION CONTINGENCY FEES FOR LAWYERS

The ALRC has proposed that the currently illegal practice of a contingency-based legal fee be permitted within the confines of a class action. The ALRC is not recommending the legalization of contingency fees more broadly. Further, such a legal fee would require court approval and be subject to judicial variation.

While the ALRC approach affords greater protections for clients, it is nonetheless highly likely to stimulate further class actions. Indeed, the ALRC acknowledges that its aim is to make the funding of medium sized actions, that are not of interest to funders, more viable.

The ALRC also recommends that if a contingency fee is used by a lawyer the lawyer must advance any disbursements and provide security for costs. When combined with the lawyer's interest in the contingency fee, the lawyers may frequently have a greater financial interest in the outcome of the litigation than any group member. The ALRC's proposal for a contingency fee is aimed at providing more funding options and promoting access to justice. However, the likely outcome is an increase in the entrepreneurial nature of federal class actions.

LITIGATION FUNDING

The ALRC discussion paper initially addressed concerns over litigation funding through recommending that funders must obtain a licence which would include conditions such as character, capital adequacy, and managing conflicts of interest. The ALRC final report has abandoned this approach in favour of giving greater powers and responsibility for the supervision of litigation funding to the Federal Court.

Concerns over insolvent funders initiating litigation but then being unable to honour indemnities to the representative party (and group members) have been dealt with through recommending a statutory presumption that third-party litigation funders will provide security for costs.

Further the ALRC recommendations provide for a suite of statutory powers to be given to the Federal Court:

- Third-party litigation funding agreements with respect to representative proceedings are enforceable only with the approval of the Court;
- The Court has an express statutory power to reject, vary, or amend the terms of such third-party litigation funding agreements;
- Third-party litigation funding agreements with respect to representative proceedings must provide expressly for a complete indemnity in favour of the representative plaintiff against an adverse costs order; and
- Australian law governs any such third-party litigation funding agreement the funder submits irrevocably to the jurisdiction of the Court.

These powers go to the core of the Attorney-General's reference and would provide the Federal Court with the necessary powers to protect the interests of group members. Litigation funders who wished to fund class actions would need to subject their funding agreements, in particular the fees that were to be charged, to court oversight.

CONSTITUTION OF CLASS ACTIONS

The group definition used in a class action attracted controversy with litigation funders' development of the "closed class", which limited group membership to those claimants who had signed funding agreements and agreed to pay a proportion of any recovery to the funder. This was in contrast to an "open class", which was brought on behalf of all claimants.

This development had two effects: diminishing access to justice by excluding group members that did not come forward and contract with the funder; and creating the conditions for a new type of competing class action, namely one brought on behalf of group members who had signed with a different funder, or on behalf of the group members who had not signed with any funder.

The ALRC has sought to return to the original approach to class actions by recommending that Part IVA of the *Federal Court of Australia Act 1976* (Cth) should be amended so that all representative proceedings are initiated as an open class. This reform will assist in promoting access to justice, but perhaps more importantly, it will remove some of the hurdles that the courts have faced in dealing with competing class actions.

The ALRC has also sought to address the issue of "class closure", which is when group members are required to take a positive act, such as registering their claim, so as to be able to participate in any settlement. If class closure occurs too early then it can have the same effect on access to justice as a closed class. However, class closure is often a necessary requirement in being able to distribute a settlement. The ALRC has recommended that the Federal Court provide criteria for when it is appropriate to order class closure during the course of a class action.

COMMON FUND

The common fund is a court order that requires all group members to contribute to the litigation funder's fee, regardless of whether they have signed a funding agreement. The common fund was put forward by academic commentators as a way to remove the need for a closed class and foster access to justice. In return for litigation funders recovering a fee from all group members the amount of the fee had to be approved by the court. In *Money Max Int Pty Ltd (Trustee) v QBE Insurance Group Limited* (2016) 245 FCR 191, the Full Federal Court of Australia made common fund orders at the request of the applicant.

The ALRC has recommended that the Court be provided with an express statutory power to make common fund orders on the application of the plaintiff or the Court's own motion.

Challenges to common fund orders were heard by the Full Federal Court of Australia and the New South Wales Court of Appeal on 4 and 5 February 2019. In the subsequent judgments the courts' power to make a common fund order was confirmed, and challenges based on the order not being an appropriate exercise of judicial power and giving rise to a contravention of Australian Constitution s 51 (xxxi), which provides for acquisition of property to be on just terms were dismissed: *Westpac Banking Corporation v Lenthall* [2019] FCAFC 34 and *Brewster v BMW Australia Ltd* [2019] NSWCA 35.

The outcome of *Westpac Banking Corporation v Lenthall* and *Brewster v BMW Australia Ltd*, assuming no further successful appeal, may support a view that an express legislative power is not required. Two appellate courts have now confirmed the existence of the power and provided guidance on how it may be exercised. However, the connection between the common fund and other areas proposed for reform, such as regulation of litigation funders' fees and competing class actions, may best be achieved through all reforms being expressly set out so as to assist with clarity in the operation of the new regime.

COMPETING CLASS ACTIONS

The growing number of competing class actions has become a major source of uncertainty, cost, and delay in Australian class actions. The Federal Court has been addressing the

issue on a case by case basis, and recently provided guidance in *Perera v GetSwift Limited* [2018] FCAFC 202. However, the court permitted a range of approaches to be adopted, depending on the circumstances in each situation:

- The relevant proceedings could be consolidated;
- A declassing order could be made in respect of one or more of the proceedings;
- There could be a joint trial of all proceedings as they are presently constituted, i.e. the 'wait and see' approach;
- There could be a permanent stay of one or more of the proceedings; and
- An order could be made closing the classes in one or more of the proceedings but leaving one of the proceedings as open class proceedings, with a joint trial of them all.

The allowance of multiple options continues the uncertainty, and depending on the option chosen, the existence of multiple class actions.

The ALRC has proposed amendments that seek to ensure that, wherever possible, there is a single class action in order to litigate a claim, including recommending that the Federal Court be given an express statutory power to resolve competing class actions. Such a reform needs to be adopted promptly.

The ALRC also weighed in on how to address competing class actions that are filed in different courts, such as in relation to the five class actions against AMP where the first was filed in the Supreme Court of New South Wales and then four more were filed in the Federal Court.

The ALRC put forward two approaches. First was to build on the *Protocol for Communication and Cooperation Between Supreme Court of New South Wales and Federal Court of Australia in Class Action Proceedings* (November 2018). The protocol was adopted in response to the AMP class action experience. The protocol provides for a joint case management hearing and for the judges from each Court to jointly determine the approach to managing the competing class actions, including selecting which action may proceed. The ALRC recommended that the Supreme Courts of states and territories with class action procedures should consider becoming parties to the protocol.

The ALRC also argued that the protocol was more effective than the earlier recommendation of the Victorian Law Reform Commission that a cross-vesting judicial panel for class actions be established. The idea being based on the U.S. Judicial Panel on Multidistrict Litigation. The ALRC expressed concern about the constitutionality of any cross-vesting judicial panel as the exercise of any judicial power is limited to the circumstances where a judge is seized of a matter.

Second, and more controversial, was to recommend that all class actions arising under the *Corporations Act 2001* (Cth) and *Australian Securities and Investments Commission Act 2001* (Cth) could only be brought in the Federal Court. This would mean that all shareholder, financial product, and financial services class actions could not be commenced in state courts.

The recommendation may need to be acceptable to the states as Australia's corporate law regime operates on the basis that the states have referred their powers over corporations to the Federal Parliament, but such referral is subject to periodic renewal.

Further, it would be unusual to specify that the jurisdiction of a court to hear a corporate law matter based on the procedural form employed, ie a class action, rather than the substantive law. Under the ALRC recommendation corporate law claims brought by a single plaintiff or multiple plaintiffs using joinder could be pursued in state courts.

SETTLEMENT APPROVAL

The ALRC has recommended the inclusion of three practices dealing with settlement be included in the Federal Court's practice note on class actions:

- Appointment of a referee to assess the reasonableness of legal costs;
- Permitting the use of a tender process for appointing a settlement administrator; and
- Requiring the settlement administrator to provide a report on the key elements of the administration, such as cost and time elapsed.

The recommendations have been previously raised by academic commentators and have to a limited extent been considered or adopted by Federal court judges. The inclusion in the practice note will hopefully assist in increasing the adoption of these practices which aim to reduce costs.

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