FUNDING CRITERIA FOR CLASS ACTIONS

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I INTRODUCTION

Class actions and other representative proceedings are now an established and essential means to ensuring access to the Australian civil justice system for individuals and companies who have been injured by corporate misconduct causing large-scale losses and who seek compensation as a result. Unquestionably, the development of commercial litigation funding in Australia in the last decade has facilitated this process as the considerable cost and risks of prosecuting mass claims are generally prohibitive and hence unacceptable to most litigants and their solicitors.

IMF (Australia) Ltd[1] ('IMF'), Australia's largest litigation funder, has financed many significant Australian representative proceedings and class actions, particularly those brought on behalf of aggrieved shareholders and investors.[2] IMF chooses its cases with care.[3] In this paper IMF's funding criteria for multi-party actions are examined and discussed.

Commercial litigation funders, such as IMF, agree to meet the claimant's legal costs and disbursements in the litigation and pay any adverse costs orders which might be made in the event the litigation fails. The funder will also provide any security for costs which the claimant may be ordered to make. In

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1 IMF (Australia) Ltd is a public company listed on the Australian Securities Exchange since 2001 (ASX:IMF). It is the holder of Australian Financial Services Licence No 286906 and is authorised to enter into litigation funding agreements with retail and wholesale clients pursuant to the provisions of the licence and the *Corporations Act 2001* (Cth) ('*Corporations Act*'). IMF has identified multi-party claims as a key asset class in its investment business.

2 IMF funded the claim by shareholders against Aristocrat Leisure Limited which resulted in a confidential settlement but which has been reported to be in excess of $140 million and the largest class action settlement in Australia to date: see Vincent Morello, 'Aristocrat Pays Out $144m Jackpot', *Sydney Morning Herald* (Sydney), 29 August 2008. See also *Dorajay Pty Ltd v Aristocrat Leisure Limited* [2009] FCA 19 (Unreported, Stone J, 21 January 2009).

3 IMF (Australia) Ltd, *2009 Annual Report* (2009) 7: IMF has lost four out of 140 funded cases over the last 8 years.

return, the claimant agrees to reimburse the funder's direct outlays on the litigation out of any settlement or damages award recovered by the claimant and to pay the funder an agreed percentage of the balance remaining after reimbursement. The funder's return is in all cases contingent on the claimant's success in the litigation.

From listing, IMF identified large-scale multi-party litigation, including class actions, as a potential source of business and it has subsequently become the largest single component of IMF's litigation portfolio. IMF separates its funded claims into three classes, namely: insolvency claims, commercial claims and 'group claims', the latter covering class actions, other representative proceedings and multi-plaintiff proceedings.

Initially, IMF had no group actions in its portfolio. By 30 June 2005, however, IMF reported that it was funding 10 group actions with an estimated total claim value of $531 million and 24 commercial and insolvency claims with a combined estimated claim value of $394 million.[4] By 30 June 2009, IMF was funding 19 group actions with an estimated claim value of $875 million and 10 commercial and insolvency actions with a combined claim value of $182 million.[5] That is, the share (by value) of multi-party litigation in IMF's claims portfolio grew from nil in 2001 to just under 60 per cent in 2005, and subsequently to over 80 per cent by 2009, while the estimated value of these claims rose from nil to $875 million in that time. The strong growth in IMF's multi-party litigation portfolio serves to highlight the critical role that multi-party case selection plays in the growth of IMF's business and in the litigation funding market in Australia generally.

Based on past experience and current market conditions, IMF expects that in the future multi-party litigation will remain a prominent component of its total claims portfolio. This is not only because of the recent turmoil in global debt and equity markets and the resulting adverse impact on many Australian shareholders and investors,[6] but also through the continued diversification of IMF's business in relation to the funding of cartel claims and other mass wrongs.

The growth, both in the number and the value of multi-party claims since third party funding became available eight years ago to facilitate their prosecution, has caused the process by which multi-party actions are selected for funding to become progressively more sophisticated. For the first two years after

4 IMF (Australia) Ltd, *2005 Annual Report* (2005) 8.
5 IMF (Australia) Ltd, *2009 Annual Report* (2009) 13.
6 IMF (Australia) Ltd, *2009 Annual Report* (2009) 6–7.

listing, IMF chose not to fund class actions,[7] preferring instead to fund group actions.[8]

There were a number of reasons for this preference, most notably a concern that the conventional view of the class action regime as an 'opt out' process would inevitably result in 'free riders' – that is, claimants who chose not to sign a funding agreement, but who would benefit from the outcome of the class action without having to contribute towards its cost.[9] This issue was confronted in the first class action funded by IMF, that against Aristocrat Leisure Limited, which was commenced in 2003.[10] The issue was ultimately resolved by the Federal Court of Australia in a subsequent decision by the Full Court in favour of a 'closed class', which could comprise the funder's clients only, as is discussed further below.[11]

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7 The term 'class action' refers to proceedings commenced pursuant to Part IVA of the *Federal Court of Australia Act 1976* (Cth) or Part 4A of the *Supreme Court Act 1986* (Vic).

8 The term 'group action' refers to either multi-plaintiff proceedings or representative proceedings. Multi-plaintiff proceedings are proceedings commenced by two or more persons whose claims raise common issues of law or fact and where the relief claimed is in respect of, or arises out of, the same transaction or series of transactions: see Order 6 rule 2 of the *Federal Court Rules*, Order 6 rule 19 of the *Uniform Civil Procedure Rules* 2005 (NSW), rule 9.02 of the *Supreme Court (General Civil Procedure) Rules* (Vic) and similar provisions in the Rules of Court of the Supreme Courts of the other States and Territories. The claims funded by IMF against Patrick Corporation Limited and the Finance Brokers Supervisory Board utilised this procedure. Representative proceedings are proceedings based on the former practices of the Court of Chancery in England and are provided for in the rules of the Federal Court and State and Territory Supreme Courts. For example, Order 6 rule 13 of the *Federal Court Rules* provides that where numerous persons have the same interest in any proceeding, the proceeding may be commenced, and, unless the Court otherwise orders, continued by or against any one or more of them as representing all or as representing all except one or more of them.

9 Litigation funders maintain that 'in order for funding to be made available on an equitable basis, the funder's outlays and fees must be spread across all members of the represented group': John Walker, 'The Changing Funding Environment in Class Actions' (Paper presented at the Maurice Blackburn International Class Actions Conference, Sydney, 25–26 October 2007) 6. IMF advocates that Part IVA be amended to entitle representatives to exclude free riders and only include people in the class who are willing to share in the cost of the proceedings: at 8.

10 *Dorajay Pty Ltd v Aristocrat Leisure Limited*, Federal Court of Australia, Matter NSD 362 of 2004.

11 *Multiplex Funds Management Ltd v P Dawson Nominees Pty Ltd* (2007) 164 FCR 275 ('*Multiplex*'). The limitation of class action proceedings to those who actively consent (or 'opt in') to their inclusion in the group is a controversial area: see the discussion in Victorian Law Reform Commission, *Civil Justice Review Report*, Report No 177 (2008) 524–8. The Commission recommended that 'there should be no legal impediment to a class action proceeding being brought on behalf of a smaller group of individuals or entities than the total number of persons who may have the same, similar or related claims, even if the class comprises only those who have consented to the conduct of proceedings on their behalf': at 559. See also the report by the Access to Justice Taskforce established by the Commonwealth Attorney-General's Department: Access to Justice Taskforce, *A Strategic Framework for Access to Justice in the Federal Civil Justice System* (2009). The Taskforce recommended that Part IVA of the *Federal Court of Australia Act 1976* (Cth) should be reviewed to consider 'whether the current opt-in arrangements for class actions funded by litigation funders are appropriate or should be amended': at 117.

Since this development, and a coincidental relaxation in the criteria for representative proceedings,[12] IMF and its clients may choose to utilise either the class action or the group action procedure in pursuing multi-party claims. IMF has predominantly chosen to utilise the class action regime as the vehicle to pursue the multi-party shareholder and cartel claims it funds, principally because findings on the common issues are binding on all parties to the class action proceedings.[13] However, group actions also continue to be funded where appropriate.[14]

II THE POPULATION OF CLAIMS

The focus of this paper is on the criteria by which IMF decides to fund class actions. By definition, this limits the population of potential actions to those that:

1. meet the threshold requirements of section 33C of the *Federal Court of Australia Act 1976* (Cth) ('*FCA Act*');
2. would be unlikely to be subject to a discontinuance order under section 33N of the *FCA Act* in the event a class action was initiated; and
3. are otherwise commercially viable to fund as a class action.

Section 33C of the *FCA Act* permits a class action to be brought where:

- seven or more persons have claims against the same person;

12 In *O'Sullivan v Challenger Managed Investments Ltd* (2007) 214 FLR 1 ('*Challenger*') claims for damages in proceedings commenced under rule 7.4 of the *Uniform Civil Procedure Rules 2005* (NSW) were struck out on the grounds that the plaintiff and the persons she represented did not have the 'same interest' in the proceedings because the relief sought was not common to them all. The effect of the *Challenger* decision was subsequently reversed in New South Wales by an amendment to rule 7.4 (with effect from 9 November 2007) to provide that the claims must be 'in respect of, or arise out of, the same, similar or related circumstances' and 'give rise to a substantial common issue of law or fact'. Initially the new rule was interpreted restrictively (*Jameson v Professional Investment Services Pty Ltd* (2007) 215 FLR 377) but on a successful appeal from the Supreme Court's judgment, the New South Wales Court of Appeal adopted a more purposive interpretation of the rule that facilitated the bringing of a representative proceeding on behalf of a group of investors who had lost money in the Westpoint collapse: *Jameson v Professional Investment Services Pty Ltd* (2009) 72 NSWLR 281 ('*Jameson*'). The class in *Jameson* was defined by reference to the group members having entered into a litigation funding agreement with a funder. Chief Justice Spigelman, in delivering the Court's judgment, considered that the trial judge had 'failed to give weight to the significant access to justice issue that arises in this regard. In the absence of a litigation funder it is likely that most of the proceedings his Honour was considering would not be instigated at all': at 303.

13 For example, the claims funded by IMF against Aristocrat Leisure Limited, Concept Sports Limited, Village Life Limited, Challenger Managed Investments Limited, Westpoint Group of Companies, AWB Limited, Downer EDI Limited, Centro Properties Limited, Centro Retail Trust, Credit Corp Group Limited, the Commonwealth of Australia relating to regulatory action taken against Pan Pharmaceuticals Limited (in liquidation), Qantas Airways Limited and other airlines (the 'Air Cargo' litigation) and MFS Limited – Premium Income Fund. The AWB proceeding commenced as a representative proceeding and was subsequently converted into a class action under Part IVA: *Watson v AWB Ltd* [2007] FCA 1367 (Unreported, Gyles J, 22 August 2007).

14 See, eg, *Newman v Financial Wisdom Ltd* (2004) 183 FLR 164 and *Re Opes Prime Stockbroking Limited* (2009) 258 ALR 362.

- the claims of all those persons are in respect of, or arise out of, the same, similar or related circumstances; and
- the claims of all those persons give rise to a substantial common issue of law or fact.

If these requirements are met, a proceeding may be commenced by one or more of those persons ('the representative') as representing some or all of them ('the group members').

Under section 33N of the *FCA Act*, the Court, of its own motion or on an application by a respondent, may order that the proceeding not continue as a class action where it is in the interests of justice to do so because:

- the costs of the class action are likely to exceed the costs that would be incurred if each group member conducted a separate proceeding;
- all of the relief sought could be obtained otherwise than in the class action;
- the class action is not an efficient and effective means of dealing with the claims of group members; and
- the class action is an otherwise inappropriate means to pursue the claims.

The third factor encompasses a wide range of productivity considerations which reflect a concern about whether the proposed class action will achieve the resolution of material issues in dispute more efficiently and effectively than other available procedures.

Experience has shown that the causes of action which are most likely, on their face, to fulfil these statutory and efficiency criteria are claims arising from breaches of market protection legislation, specifically being the continuous disclosure,[15] product liability[16] and competition law (anti-cartel)[17] regimes.[18] These regimes are separately considered and discussed below. Before doing so, it is convenient to examine funding criteria generic to all class actions.

III GENERIC FUNDING CRITERIA

The investment decisions taken by litigation funders in respect of class actions and other multi-party proceedings are made within a risk management framework which identifies and separately assesses risks associated with the class action procedure itself, liability, causation and quantum of loss issues, the

15 *Corporations Act 2001* (Cth) ss 674(2), 1041H; and *Australian Securities and Investments Commission Act 2001* (Cth), s 12DA(1) ('*ASIC Act*').

16 *Trade Practices Act 1974* (Cth) pts V, VI.

17 *Trade Practices Act 1974* (Cth) pt IV as recently amended by *Trade Practices Amendment (Cartel Conduct and Other Measures) Act 2009* (Cth).

18 Claims relating to market protection regulations concerning financial services (predominantly involving the provision of misleading or deceptive financial advice) form a significant percentage of IMF's funded multi-party claims but are rarely resolved through class actions due to the facts relating to the advice and the claimants' reliance upon it being specific to each individual concerned.

enforceability of any judgment or settlement and the overall commercial viability and manageability of the proposed litigation.

A Disqualifying Factors

As an initial check, IMF assesses the proposed class action against a range of disqualifying factors identified from IMF's experience. If any of these exist, the claim is immediately rejected. Disqualifying factors include:

(a) liability evidence that is irremediably too weak, too dependent upon oral evidence or which requires a factually-rich and complex forensic inquiry to identify;

(b) a clear risk that, on the best possible case for the claimants, their causally connected loss is likely to be less than an amount which would make the litigation commercially viable or that causation may not be able to be established at all;

(c) that the claim is made up of too many small claims;[19]

(d) a lack of confidence in, or transparency concerning, the proposed respondent's (or respondents') capacity to meet any judgment or pay a reasonable settlement;

(e) that the relief sought is limited to injunctions, declarations or other non-monetary relief only; and

(f) that the likely cost of the class action (including all potential adverse cost orders) is too large relative to the likely settlement or judgment to make funding the litigation commercially viable.

If the proposal does not fall within any of the disqualifying factors, IMF then conducts a thorough due diligence check on the potential class action. This process is applied to all potential funded litigation as IMF has no interest in funding claims which lack merit or are otherwise unlikely to be successful.[20]

B Liability Risks

IMF identifies for itself the likely statutory breaches or contraventions which might be the subject of the class action and then assesses the likelihood that the relevant breach or contravention will be successfully established. This involves examining:

(a) each of the elements of the alleged cause or causes of action;

(b) the likely defences;

(c) any likely cross-claims; and

(d) the documentary and oral evidence available in respect of the element or elements of the cause of action that will primarily be in issue in the proposed proceedings.

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19 See further discussion in Parts V and VI of this article.

20 IMF (Australia) Ltd, *2009 Annual Report* (2009) 6–7.

The statutory causes of action provided in the continuous disclosure, product liability and anti-cartel legislative regimes are generally more straight-forward to establish than the equivalent actions at common law and, in the context of shareholder non-disclosure claims in particular, are determined in large part on publicly-available evidence, including documents filed with the Australian Securities Exchange.

Although IMF's protocols require claims to be viable on a stand-alone basis, IMF may entertain applications for funding for matters which may serve to develop precedents in relation to liability, causation and quantum which could be expected to enhance claimants' rights and facilitate the efficient and effective conduct of claims arising under market protection legislation.[21]

C Causation Risks

In many cases, applicants for funding may be able to prove liability and damage, but there may be a question over whether they are able to prove their losses were causally connected to the relevant breach or contravention. There are two aspects to this risk from the funder's point of view. The first is the risk that the court will find that the claimants' losses were not, as a matter of fact or law, caused by the contravening conduct. The second is that the cost of proving individual losses may be excessive and so render the litigation unviable for funding.

Where there is a clear risk, on any interpretation of the law or facts, that the claimants will be unable to establish causation, the claim will be rejected by the funder at an early stage, as noted in Part III (A) above. However, if the funder considers that these risks are manageable, then the funder may decide to accept them and proceed with the funding.

These risks arise in shareholder class actions and are discussed in Part IV below. However, as an example, if proving each group member's loss obliges their lawyers to prove their individual reliance upon a misrepresentation,[22] then claims which may be otherwise viable for funding may be uneconomic to pursue due to the high costs and risks associated with proving causation for each group member.

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21 Although not a class action, a good example is the funding of the claims by Mr Luka Margaretic against Sons of Gwalia Ltd (then subject to a Deed of Company Arrangement). The litigation resulted in a landmark decision of the High Court of Australia which held, by a 6:1 majority (Callinan J dissenting), that a shareholder with a claim against a company for misleading or deceptive conduct can prove in the administration or liquidation of the company and rank *pari passu* with the claims of other unsecured creditors: *Sons of Gwalia Ltd v Margaretic* (2007) 231 CLR 160.

22 As distinct from proving that the misrepresentation caused the market in the relevant securities to be inflated which thereby caused loss to all purchasers in the period the market is proved to be inflated. This is known as the Market Reliance Theory. This was a live issue in the Aristocrat class action but the proceedings settled before the Court was required to rule on whether causation can be established on the basis of this theory under Australian law.

D Quantum Risks

Whilst risks relating to the quantification of the losses of group members might not be quite as punishing for a funder as liability or causation risks when they crystallise,[23] the identification and management of this species of risk are essential components in selecting and proportionately managing viable class actions.

In IMF's experience, applicants and group members often come to litigation with inflated expectations. This is a risk funders must carefully manage. A realistic and thorough understanding of the range of potential losses and recoverable damages must be gained before proceedings are commenced,[24] which may involve the funder obtaining an independent expert assessment of the loss.

E Enforcement Risks

Unless the respondent or respondents have identifiable net tangible assets (including the benefit of any indemnity under an insurance policy)[25] and have the capacity to meet any likely settlement or judgment, funding is unlikely to be provided. Self-evidently, the value of any cause of action cannot exceed the capacity of the respondent to pay.

F Process Risks

The class action procedure itself creates risks that require consideration and management by a funder. Two key risks are the risk of a finding that there are no, or insufficient, common issues of law or fact to enliven the class action

23 At least in the sense that the applicant may have an argument that, given liability has been proven, it ought not to have to pay all of the respondent's costs. However, funders do not fund litigation they expect will be lost.

24 This requirement often causes otherwise viable claims not to proceed.

25 It is generally difficult or impossible to determine, with certainty, the likely level of relevant insurance cover held by a respondent as insurers insist on strict confidentiality over the terms of the policies they issue and the courts are unwilling, except in certain circumstances, to order the production of policies for inspection by claimants, their lawyers or funders. Unsuccessful applications to access respondents' insurance policies have been made recently in two multi-party matters funded by IMF: see *Lehman Brothers Australia Ltd v Wingecarribee Shire Council* (2009) 176 FCR 120; *Kirby v Centro Properties Ltd* [2009] FCA 695 (Unreported, Ryan J, 26 June 2009). Funders and claimants are left to make educated guesses about the level of cover held by respondents – a situation which is hardly conducive to the just, quick and inexpensive resolution of the underlying dispute.

jurisdiction[26] and that the class definition itself may come under successful attack.[27]

The former risk is negligible where the wrong is a breach of the market protection legislation referred to and the latter has broadly been overcome by the Full Court's decision in *Multiplex Funds Management Ltd v P Dawson Nominees Pty Ltd*.[28] This decision enabled a class to be defined by reference to those who have signed a funding agreement before the proceedings have commenced. As a result, funded litigation will only benefit persons identified and enrolled before the class action commences. These are 'opt in' claims as the group members elect to join the action. This approach, by definition, ensures that funded claims will never proceed for persons whose claims are too small or too uncertain to justify the funder incurring the expense of identification, contact, awareness creation and enrolment in the class action – a process known as the 'bookbuild'.

G Bookbuild Risks

The bookbuild risk is that insufficient claimants with insufficient claim value will join the class action by signing a funding agreement so as to make funding the action commercially viable. This risk is usually managed by making the obligation to fund conditional on achieving client support satisfactory to the funder. Satisfactory support is usually measured in terms of claim value and/or attracting a totality of claims which, when weighed against the expected costs and other risks, enable the funder to conclude that the proposed class action is viable and should proceed. Each piece of litigation is unique and so there are no fixed parameters which render a claim commercially viable (or not).

Any decision by a funder to commence a bookbuild will require the funder to form the view that a successful bookbuild is likely.

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26 See *FCA Act* s 33C; see also *Wong v Silkfield Pty Limited* (1999) 199 CLR 255.

27 See *Dorajay Pty Ltd v Aristocrat Leisure Ltd* (2005) 147 FCR 394 ('*Dorajay*'). In *Dorajay,* the Respondent sought orders that the group definition (which included a requirement that a group member sign a retainer with the lawyers, Maurice Blackburn, and a funding agreement with a subsidiary of IMF) meant that it was not in the interests of justice that the proceedings continue as a class action. Justice Stone held that the legislature had 'made a deliberate policy choice in adopting' an 'opt-out' procedure and as the group definition required a member to effectively 'opt-in' to the proceedings, this was inconsistent with the terms and policy of Part IVA of the *FCA Act*. As a result of this decision, the class action was converted into an open class proceeding. This decision was subsequently not followed in *Multiplex* (2007) 164 FCR 275.

28 See *Multiplex* (2007) 164 FCR 275. In *Multiplex*, the Full Court of the Federal Court of Australia held that the group definition adopted in that case (a definition in very similar terms to that in issue in *Dorajay* but with the important distinction that it required entry into a funding agreement at the commencement of the proceedings) was not inconsistent with sections 33C, 33E or 33J of the *FCA Act*. The features of the group definition approved in *Multiplex* have been adopted for use in other Part IVA actions funded by IMF.

H Litigation Management Risks

In addition to the specific risks referred to above, a funder will also examine the funding proposal from a management and financial risk perspective by considering the following questions:

(a) Which lawyers are to act for the claimants and do they have the requisite skills and experience?

(b) Who will be the representative? Are the lawyers and the representative willing to work with the funder in an efficient and productive manner?

(c) What is the likely budget for legal costs and disbursements? How likely is it to be achieved or overrun?

(d) In which jurisdiction, Court and list will the proceedings be commenced?

(e) How long are the proceedings likely to take to reach closure of pleadings, discovery, statements, allocation of a trial date and judgment?

(f) How much is the litigation likely to cost for each of these phases?

(g) What is the likelihood of an adverse costs order and what is the likely magnitude of any such order?

IV SHAREHOLDER CLASS ACTION FUNDING CRITERIA

Over the last eight years, IMF understands that 14 shareholder class actions have been filed in Australia in proceedings involving solvent respondents, eight having concluded and six remaining current. IMF has funded the majority of these actions.

The primary causes of action relied upon in such claims are sections 674 and 1041H of the *Corporations Act*, being the continuous disclosure obligation and the prohibition on misleading and deceptive conduct in relation to a financial product or a financial service.

Obviously sufficient evidence of each element of the cause of action or actions relied upon must be available to the funder during the due diligence process. The following discussion, however, focuses on three of these elements, being: (a) the materiality of the non-disclosed information in relation to the price or value of the relevant securities, (b) the causal link between the non-disclosure and the pleaded loss, and (c) the quantum of the losses suffered by the group members.

One of the principal criteria in assessing shareholder claims for funding is to look at the market's reaction to the information once it is disclosed. Usually the information under examination is negative to the price of the securities.

If the drop in the securities' price upon disclosure is material[29] and the drop is unlikely to be referable to any other information not the subject of the alleged contravention, then *prima facie* the funder has cogent evidence that:

(a) the non-disclosed information was material to the price or value of the securities; [30]

(b) the failure to disclose the information in a timely manner caused the market in the securities to trade at a price higher than it would have traded at had the information been disclosed in a timely manner;

(c) the price or value of the securities was inflated from the time of the failure to disclose until the material information was disclosed (the 'Inflation Period') in an amount referable to the price drop when disclosed; and

(d) the quantum of the loss can be estimated by reference to the inflation in the price or value of the securities caused by the contravention and the number of the securities purchased in the Inflation Period and still held by group members at the conclusion of the Inflation Period.[31]

If the drop in the price or value of the securities is immaterial after disclosure,[32] then there will be limited interest in funding any claim unless causally connected loss and materiality can be proven in some other way.

Other selection criteria for shareholder class actions, and their relevance, include:

- Trading volumes and analyst coverage. These factors bear on the scale of potential losses and evidence of an efficient market in the securities concerned.
- The market capitalisation of the company. This bears on the company's capacity to meet any settlement or judgment.
- The market reaction to the alleged misconduct, which may be judged on a spectrum from careless to heinous. This factor bears on the bookbuild risks referred to in Part III(G) above.
- The likely depth and complexity of the forensic inquiry to prove the contravention and the causally connected loss. This factor bears on the liability, causation and litigation management risks outlined in Part III (B), (C) and (H) above.

29 That is, the price drops by an amount of five per cent or more as a result of the disclosure.

30 *Corporations Act 2001* (Cth) s 674(2)(c)(ii).

31 This is one of the four or five loss methodology theories that will remain a theory until this area of the law obtains some certainty from an appellate court judgment.

32 An example of a case in which the applicant was unable to demonstrate that selective disclosures of the relevant information to the market caused the share price to decline is *Taylor v Telstra Corp Ltd* [2007] FCA 2008 (Unreported, Jacobson J, 13 December 2007) [79].

V PRODUCT LIABILITY CLASS ACTION FUNDING CRITERIA

There are numerous examples of product liability class actions in the reported cases, particularly following the introduction of Part IVA to the *FCA Act* in 1992. However most, if not all, of these claims preceded the availability of third party litigation funding.

Product liability claims arise in diverse ways. Claims involving pharmaceutical and medical devices, claims arising from contaminated aviation fuel and agricultural chemicals, personal injury from asbestos contamination, defective products such as motor vehicles and other types of machinery and defective building products have all been reported.[33]

There are, however, a number of features of product liability claims which pose process, liability and causation risks for a funder and which (in a general sense) make funding these types of claims commercially unattractive.

A Size of Individual Claims and Proof of Causation and Loss

While a class action is primarily concerned with the conduct of the representative's claims, consideration must also be given to the ease of proof of causation and loss for each group member. Often questions of causation will be answered by a determination of the common issues of law and fact. However, having to prove the losses suffered by individual group members can be time consuming, factually complex and consequently costly. The risk of group members being put to proof on all issues must also be taken into account when considering class actions for funding.

Depending upon the nature of the product and the consumer, product liability claims conducted as class actions are often an aggregation of claims of fairly small individual monetary value. In *Ryan v Great Lakes Council*,[34] a case which went from a single judge of the Federal Court to the Full Court and then on appeal to the High Court of Australia, the applicant was awarded only $30 000 by Wilcox J in relation to his personal claims. This action would never have been supported by a funder once the cost and risk of the litigation were objectively weighed against the possible litigation outcomes.

Product liability claims may often be intertwined with other claims, for example claims against doctors for pharmaceutical and medical products or

33 Other examples include *Bright v Femcare Ltd* (2001) 188 ALR 633 (litigation relating to the 'Filshie' clip and its failure to properly occlude fallopian tubes); *Courtney v Medtel Pty Ltd* (2003) 126 FCR 219 (litigation relating to the wiring of pacemakers); *Nendy Enterprises Pty Ltd v New Holland Australia Pty Ltd* [2001] FCA 582 (Unreported, Whitlam J, 6 November 2001) (litigation involving the purchase of combine harvesters) and *Ryan v Great Lakes Council* (1999) 102 LGERA 123 (litigation relating to the contamination of oysters).

34 *Ryan v Great Lakes Council*, Federal Court of Australia, Matter NG 183 of 1997.

claims against other types of advisers.[35] Claims involving parties outside the distribution channel can make proof of causation a difficult and complex exercise and may mean that the action cannot proceed as a class action. There may be insufficient commonality of issues between the group members and the claims may be better suited to being pursued in a group action. The Part IVA procedure carries with it a range of cost and risk efficiencies and a group of claims which cannot be conducted as a class action may be unattractive to a funder for this reason.

Claims for compensation for personal injury are usually unattractive to commercial funders and IMF's investment protocols do not presently favour funding claims of this type. These claims rely on evidence (usually oral evidence) from individual applicants which may give rise to a number of litigation risks and, in any event, are generally already well supported by lawyers acting on a 'no win, no fee' basis.

B Risks Posed By Multiple Defendants

Part IVA of the *FCA Act* requires that the applicant and group members each have claims against the same person. This requirement has been the subject of judicial disagreement and the precise requirements of section 33C(1)(a) of the *FCA Act* remain a matter of debate.[36]

Product liability cases generally involve claims against manufacturers and other parties in a distribution chain. To capture all relevant parties who may be liable for the losses incurred by the applicant and group members, the action may have to proceed against multiple respondents. This can increase process and financial risk to a funder.

Process risk arises from conducting a claim against multiple respondents who are likely to be separately represented. This inevitably leads to delay and inefficiency in the conduct of the proceedings. Further, the financial risk for the funder increases due to potential liability for multiple claims for adverse costs should the representative's claims fail.

A further complicating factor for claims (other than for personal injury) is the proportionate liability legislation which enables a Court to limit the liability of individual wrongdoers.[37] This regime is of course not unique to class actions. However, in class action claims involving apportionable claims, the proportionate liability legislation:

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35 See, eg, Justice Stone's decision in *Bright v Femcare Ltd* (2001) 188 ALR 633 in which the Court formed the view that there were few common issues between the group members and the common issues which did exist were closely intertwined with issues which were not common. These factors led the Court to conclude that it was not effective or efficient to permit the litigation to proceed as a class action. This decision was reversed on appeal: *Bright v Femcare Ltd* (2002) 195 ALR 574.

36 *Philip Morris (Australia) Ltd v Nixon* (2000) 170 ALR 487 ('*Philip Morris*') (which held that all class members had to have individual claims against all respondents); the *Philip Morris* decision was not followed by a majority of the Full Court in *Bray v F Hoffman-La Roche Ltd* (2003) 130 FCR 317. For a useful summary of this issue see Victorian Law Reform Commission, above n 11, 528–31.

37 See, eg, *Civil Liability Act 2002* (NSW) ss 34, 36; *Wrongs Act 1958* (Vic) pt IVAA; *Trade Practices Act 1974* (Cth) pt VIA; *Corporations Act 2001* (Cth) pt 7.10, div 2A; *ASIC Act* pt 2, sub-div GA.

(a) places an increased burden on an applicant to ensure that all appropriate parties are sued so as to avoid the risk of obtaining a judgment which may only relate to a percentage of the actual loss and damage incurred; and

(b) transfers to the applicant the risk of an insolvent respondent.

This legislation poses additional challenges for funders in case selection and assessment of enforcement risk as actions cannot simply be pursued against those parties with the greatest capacity to meet an award of damages in the expectation that those parties will in fact be required to meet all of any judgment.

C Controversies Between Experts

A product liability claim often involves technical evidence relating to the product and whether the product meets relevant standards and other criteria. This inevitably leads to the requirement for expert evidence and assistance.

From a funder's perspective, cases involving disputes which may turn on whether one body of expert opinion is preferred over another may not be commercially attractive as this can make the outcome of the dispute very difficult to accurately predict and more expensive to achieve.

VI CARTEL CLASS ACTION FUNDING CRITERIA

Class actions for the recovery of losses caused to victims of cartels appear at face value to be well suited to litigation funding. Generally large losses are sustained by numerous businesses and individuals, the cartelists are usually solvent and well able to meet an award of damages, cartels are surprisingly common and the cartel itself is likely to have been the subject of detailed investigation (and often successful prosecution) by the Australian Competition and Consumer Commission ('ACCC') or overseas' regulators or class action lawyers.

A contemporary example is the international air cargo cartel, under which a large number of airlines are alleged to have conspired to fix certain prices for international air freight services. The cartel has given rise to investigations by a number of regulators, including the ACCC, the European Commission and the United States Department of Justice. It has resulted in class actions being brought in the United States, Canada and Australia and pending and successful

prosecutions (including the imposition of fines on airlines and jail sentences on executives) in the United States and elsewhere.[38]

The high cost of litigating, the generally small individual losses and the significant adverse cost risks generally deter all but the largest corporate victims from bringing an action for damages without financial support. A notable recent example was the claim brought by Cadbury Schweppes against Amcor and Visy arising out of a cartel that allegedly fixed prices in the cardboard box market in Australia (and had been the subject of a successful penalty proceeding by the ACCC against one of the cartel members, Visy, which agreed to pay a penalty of $36 million for its involvement in the cartel).[39] The claim was settled in July 2009 immediately prior to a scheduled 12-week trial.[40]

The private enforcement of anti-cartel laws in Australia through funded class action proceedings is, however, subject to three primary limitations.

A Class Dispersion Risks

First, victims may be too dispersed to locate and organise or may simply be too numerous, requiring the identification of a smaller, more manageable, sub-class. In the class action against the vitamins cartel, the group members were initially defined as:

> … persons who between 5 March 1992 and 5 July 1999 purchased in Australia all or some of vitamins A, B1, B2, B5 (Pantothenic Acid), B6, B9 (Folic Acid), B12, C, E, Beta Carotene, Canthaxanthin, Astaxanthin …, either directly or indirectly by way of the purchase of foods, beverages, vitamin pills or capsules or other products which contained one or more class vitamins supplied by one or more of the respondents …[41]

This class potentially covered every person in Australia. The applicant subsequently applied for leave to amend the pleadings to confine the claims to certain animal nutrition and health vitamins and to narrow the definition of group

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38 The ACCC instituted proceedings against Qantas Airways Limited and British Airways Plc in 2008, which resulted in civil penalties being ordered against those airlines of $20 million and $5 million respectively, and has brought further proceedings for penalties against Singapore Airlines Cargo Pte Ltd in the Federal Court: ACCC, 'ACCC Institutes Proceedings Against Singapore Airlines Cargo Pte Ltd For Alleged Price-Fixing' (Press Release # MR 370/08, 22 December 2008). Fifteen international airlines alleged to have been participants in the cartel have pleaded guilty or agreed to do so to charges filed by the Antitrust Division of the United States Department of Justice resulting in fines totaling more than US$1.6 billion and the sentencing of four airline executives to jail: US Department of Justice, 'Dutch Airline Executive Agrees to Plead Guilty for Fixing Prices on Air Cargo Shipments' (Press Release, 29 April 2009). On 15 December 2008, the New Zealand Commerce Commission commenced proceedings against 13 airlines and 7 airline staff 'for extensive and long-term cartel activity in the air cargo market': New Zealand Commerce Commission, 'International air cargo cartel to be prosecuted'(Press Release No 75, 15 December 2008). In Australia, IMF is funding the class action proceedings brought against Qantas and other airlines for their alleged role in the cartel: see *Auskay International Manufacturing & Trade Pty Ltd v Qantas Airways Ltd* (2008) 251 ALR 166.

39 *Australian Competition and Consumer Commission v Visy Industries Holdings Pty Ltd (No 3)* (2007) 244 ALR 673.

40 Blair Speedy, 'Cadbury settles its claim on cartel', *The Australian* (Sydney), 23 July 2009, 19.

41 *Bray v F Hoffman-La Roche Ltd* [2003] FCA 1505 (Unreported, Merkel J, 19 December 2003) [2].

members to manufacturers, distributors and suppliers of those vitamins or of products containing them, provided the group members spent at least $2000 on the relevant vitamins or products containing them. Leave was granted with Merkel J commenting:

> One of the difficulties with the proceeding is the extraordinary width of the definition of the group members who comprise all persons who purchased vitamins or products containing vitamins in Australia in the period between 5 March 1992 and 5 July 1999. Further, the wide range of vitamin products that are the subject of the claims of group members and the complexity and duration of the cartel arrangement will result in the conduct of the proceeding being complex, difficult and expensive.[42]

As a result of this experience, subsequent class actions typically employ threshold criteria to ensure that the class represents claimants who are likely to have suffered reasonable losses. In the Australian air cargo class action, the group member definition includes the requirement that the claimant is resident in Australia and during the period covered by the claim (1 January 2000 to 11 January 2007) paid more than $20 000 for the carriage of goods to or from Australia by air.[43] Narrowing the class in this manner is necessary to ensure that the litigation is manageable, economically viable to fund and conduct and potentially more likely to settle.[44]

B Evidentiary Risks

Second, evidence of collusion may be difficult or impossible to obtain. Cartels are, by their nature, secret. While the funder can usually confirm both the existence and the overall economic impact of the cartel from the ACCC's (and other regulators') public announcements, establishing liability in any proceedings needs admissible evidence.

The most straightforward evidentiary sources are the statements and documents assembled by the ACCC during its investigation. The ACCC,

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42 Ibid [8]. The class action was ultimately settled for $30.5 million plus costs of $10.5 million: *Darwalla Milling Co Pty Ltd v F Hoffman-La Roche Ltd (No 2)* (2006) 236 ALR 322.

43 *Auskay International Manufacturing & Trade Pty Limited v Qantas Airways Ltd* (2008) 251 ALR 166, 175.

44 A factor which has contributed to the narrowing of class definitions in price-fixing cases is the absence in Australia of a well-developed, legislatively-endorsed, *cy-près* remedy. Under a *cy-près* scheme the Court can order, where it is impractical or not feasible to pay any damages to individual claimants, that the unclaimed damages be distributed for a purpose as near as possible to the interests of the class members and other victims of the misconduct. The inability to fully distribute a damages award may arise where the claimants are too numerous to identify or where the costs of distributing the damages exceed the award itself. Rachael Mulheron has observed: 'Indeed, in the context of private actions arising out of cartel activity, for example, widespread consumer detriment can, in some cases, *only* be effectively dealt with by means of a functional and proportionate *cy-près* damages doctrine': see Rachael Mulheron, 'Cy-près Damages Distributions in England: A New Era for Consumer Redress' (2009) 20 *European Business Law Review* 307, 307. The Victorian Law Reform Commission made a number of recommendations that the Victorian Supreme Court should have the power to order *cy-près* remedies: Victorian Law Reform Commission, above n 11, 559–60. The Access to Justice Taskforce has also recommended that Part IVA of the *FCA Act* should be reviewed to consider 'whether the Court should be allowed to award *cy-près* remedies': Access to Justice Taskforce, above n 11, 117.

however, strongly resists requests for disclosure of evidence in the context of actual or threatened civil proceedings against the cartel for fear of discouraging whistleblowing by cartelists who may seek the protection of the ACCC's immunity policy for cartel conduct.[45]

Under the policy, the ACCC may grant immunity from ACCC-initiated civil proceedings to parties involved in the cartel conduct. The policy is to be read and interpreted in accordance with guidelines published by the ACCC.[46] The guidelines make it clear that the ACCC regards the policy as an essential tool to 'penetrate the cloak of secrecy' which envelops cartels and to destabilise them by encouraging 'a race to the ACCC's door' by applicants for immunity.[47]

Claimants had been making progress in the courts in gaining access to the ACCC's files, notwithstanding the ACCC's opposition.[48] This is expected to be severely set back by the introduction of restrictive 'protected cartel information' provisions in the *Trade Practices Act 1974* (Cth) itself.[49] Confidentiality provisions in employment contracts may also prevent a funder or its clients from utilising evidence from former employees of the cartel.[50]

C Loss Quantification Risks

Third, practical and theoretical issues may preclude the funder making a reasonable estimate of the recoverable losses. Two issues bedevil this task: first, determining the 'overcharge' levied by the cartel on its customers and, second, quantifying the extent to which the overcharge was 'passed through' to the victims' customers or even on to their customers (that is, 'indirect purchasers'

45 ACCC, *ACCC Immunity Policy for Cartel Conduct* (2009) <http://www.accc.gov.au/content/item.phtml?itemId=879795&nodeId=9dbfaa9140a83b9fd5adfe3a4ed07bd9&fn=Immunity%20policy%20for%20cartel%20conduct.pdf> at 18 October 2009.

46 ACCC, *ACCC Immunity Policy Interpretation Guidelines* (2009) <http://www.accc.gov.au/content/item.phtml?itemId=879795&nodeId=eeb4d51c0be82c9b92549c6edde4a00a&fn=Immunity%20policy%20interpretation%20guidelines.pdf> at 18 October 2009.

47 Ibid [8], [94].

48 *Cadbury Schweppes Pty Ltd v Amcor Ltd* (2008) 246 ALR 137 (ACCC's claim to public interest immunity and legal professional privilege in documents created in connection with the investigation of the cardboard box cartel disallowed); *Australian Competition and Consumer Commission v Cadbury Schweppes Pty Ltd* (2009) 174 FCR 547 (dismissing an appeal against the disallowance of the claim for legal professional privilege).

49 Sections 157(1A), (1B), 157B, 157C as inserted by the *Trade Practices Amendment (Cartel and Other Measures) Act 2009* (Cth). The Amendment introduced criminal sanctions for breaches of the *Trade Practices Act 1974* (Cth) anti-cartel provisions. 'Protected cartel information' is information given to the ACCC in confidence which relates to a breach or possible breach of those provisions. Disclosure of protected cartel information is possible only with the leave of the Court or Tribunal or in the discretion of the ACCC, in each case with the decision-maker having regard to an exhaustive list of criteria which arguably favours non-disclosure.

50 *AG Australia Holdings Ltd v Burton* (2002) 58 NSWLR 464.

from the cartel).[51] Both the overcharge and the level of pass-through must be estimated with reasonable accuracy. To do so requires the use of expensive specialist economic experts, the collection and analysis of voluminous data and a thorough understanding of the affected markets.[52] Funders, by virtue of their repeat player status in the market, have access to the resources necessary to evaluate losses but will undertake the work only if the claim otherwise appears to be strong.

VII CONCLUSION

It has been observed elsewhere that: 'Access to justice is undeniably a central aim of class action legislation, and commercial funding is no panacea for that objective. However, a robust commercial litigation funding market does represent a positive step towards its attainment.'[53]

This article provides a partial explanation for why, at present, class actions funded by commercial funders are not a 'panacea' for broader access to justice concerns. Funders, particularly those organised as public companies such as IMF, must primarily assess applications for funding by reference to legal, process and commercial criteria when determining whether a proposed class action should be funded. In doing so, funders perform an essential filtering function by separating, from the class action proposals that are submitted to them, those actions that will proceed from those that will not. This necessarily means that not all valid claims will make it to court, let alone be legitimately resolved.

However, market participants themselves can also play an important role in determining which actions will go forward through the bookbuild process. If, for example, sufficient shareholders are unwilling to join a proposed securities class action, the action simply will not proceed. Hence in these cases the claimants themselves ensure that the funder's financial resources are allocated to those claims with the greatest likelihood of maximising recoveries from those participants in the market whose contraventions have caused the greatest loss.

The development of litigation funding has significantly improved the prospects for effective enforcement of the market protection legislation in

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51 There is a live issue in Australian law as to whether the 'pass through' defence – that the claimant suffered no compensable loss because the overcharge was passed on to the claimant's customers – is available and which party in the litigation bears the onus of proving it. Funders acting prudently assume, for the purposes of their due diligence, that the claimants may ultimately be required to prove losses excluding any losses actually passed on.

52 For a discussion of economic issues associated with the estimation of damages in this context, see James A Brander and Thomas W Ross, 'Estimating Damages from Price-Fixing' in Stephen G A Pitel (ed), *Litigating Conspiracy: An Analysis of Competition Class Actions* (2006) 335–69. The authors state, with commendable restraint, at 336: 'Drawing inferences about how economic damage is shared between direct and indirect purchasers is a challenging problem in economic analysis.'

53 Bernard Murphy and Camille Cameron, 'Access to Justice and the Evolution of Class Action Litigation in Australia' (2006) 30 *Melbourne University Law Review* 399, 439.

Australia and, in the process, has facilitated much greater access to justice for many market participants.[54]

54 It is reported that the Aristocrat shareholder claims settlement involved the claims of about 4 000 institutional and retail shareholders with Maurice Blackburn, solicitors for the claimants, reported as stating that 'the payout represented an 80 cent return for every dollar shareholders lost before interest – record outcome': see Vincent Morello, above n 2.