Class Actions in Context

How Culture, Economics and Politics Shape Collective Litigation

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INTRODUCTION

Perhaps the most significant feature of any collective litigation regime is its economic viability: who pays, what does it cost, and does the aggregative mechanism adopted by the legislator provide the necessary incentives for pivotal actors to pursue litigation. Statutes tell us very little about the economics of class actions or the identity of the actors who economically enable class actions to exist. The case studies in this Part help fill that void.

This chapter provides a comprehensive framework within which the economics of class actions can be better appreciated. First, we review the case studies. Then, we consider them within an analytical discussion of alternative class action enablers and the institutional and economic conditions for their operation. As the case studies show, the selection of enablers will differ across jurisdictions. Finally, we examine the case studies from a broader legal and doctrinal perspective of the dominant enablers in each of the case study jurisdictions.

OVERVIEW OF THE CASE STUDIES

The case studies explored in this part illustrate the various mechanisms for funding class actions, and the impacts of these funding mechanisms on the initiation, conduct and resolution of class action litigation. As featured in these case studies, the identity of the enabling agent is a product of institutional and contextual factors. These factors go beyond the mere legislative framework that is apparent when reading each jurisdiction's class action law. The cases studies thus facilitate our understanding of the choices made in these jurisdictions among alternative class action enablers.

Chapter 8 discusses the *Royal Dutch/Shell Transport* litigation in the United States (US) and the Netherlands. In January 2004, Royal Dutch Shell disclosed that it had overstated its reserves in oil and gas by approximately 20 percent. The disclosure resulted in an immediate drop in the prices of shares on both the New York and London stock exchanges and subsequently further losses for investors worldwide. Multiple class actions were commenced in a US federal court by shareholders, resulting in large institutional investors and their allied law firms jockeying to be appointed lead plaintiff, in accordance with the US Private Securities Litigation Reform Act. By mid-June 2004, the securities class actions were consolidated and a lead plaintiff, the Pennsylvania Teachers' pension fund, was appointed to represent a putative worldwide class including investors on exchanges outside the US.

Foreign institutional investors were not pleased with this appointment. Among the largest of these investors were two Dutch pension funds, which retained a self-described American 'entrepreneurial' law firm in Delaware to represent their interests in the US court proceedings. A motion brought by the defendants challenging the jurisdiction of the US court over investors who purchased shares outside the US created uncertainty for the Dutch pension funds, whose ability to bring suits in their own country would soon become time-barred. This uncertainty, coupled with Royal Dutch Shell's position that the claims of foreign investors should not be resolved in a US Court, resulted in a unique dynamic. Both the defendants and the foreign institutional investors sought a forum outside of the US to resolve their claims—and they found it in Amsterdam under the umbrella of the Dutch Collective Mass Claims Settlement Act (WCAM). The settlement was negotiated by Royal Dutch Shell and the pension funds' American lawyers.

The Amsterdam Court of Appeals approved a binding opt-out settlement of all foreign investors' securities fraud claims totaling $358 million, and payments of lawyers' fees to the Dutch funds' American lawyers of roughly $50 million. The settlement was conditional on the US judge dismissing the non-US investors' claims. Carving out the foreign investors meant the size of the US class—and hence the settlement value and the American class counsel's fees—would be significantly reduced. Not surprisingly, class counsel objected to the elimination of the foreign class members from the American class action. Their objection was unsuccessful, and they ultimately reached a settlement on behalf of a much smaller class of US investors in the fall of 2008. As part of the deal, the American class action lawyers received fees for their contribution to the Dutch settlement on a scale commensurate with US rather than Dutch practice.

The next two case studies, described in Chapter 9, arose in Australia approximately ten years ago. The first, *Multiplex*, involved allegations that the company failed to disclose information about its construction projects, including a multi-million dollar stadium project in Wembley Park, in northwest London (UK). The case was initiated by Australian lawyers who, after having watched a television documentary recounting the delays and costs associated with Wembley Stadium, determined that there was a viable action on behalf of Multiplex investors who had suffered losses as a result of the company's non-disclosure. Finding a suitable and willing representative plaintiff, however, proved difficult. While institutional investors had about 95 percent of the claims against Multiplex, none were prepared to step forward. Chapter 9 explores the possible rationales for such reticence.

Though committed to prosecuting the action, the lawyers' firm was not willing to assume all of the financial risks of the litigation. In Australia, unlike Canada, Israel and the US, lawyers are not permitted to charge contingency fees, and the cost-shifting rule prevails; as a result, to pursue complex litigation, funding must be secured from another entity. In Australia, that entity is a commercial litigation funder, which invests in litigation in pursuit of profit. The lawyers in *Multiplex* ultimately found a Canadian commercial funder willing to step in. The presence of the funder led to significant satellite litigation that has shaped the class action landscape in Australia.

Multiplex settled before trial, as most Australian class actions do. However, the second Australian case study, *Aristocrat*, broke that mold. The case went to trial in 2007 and was settled after a four-week trial, before a judgment was issued. Commenced in late 2003, shareholders in *Aristocrat* alleged that they had suffered losses due to the defendant Aristocrat's misrepresentations about sales and projected profitability. The action arose when a commercial litigation funder became aware of problems at Aristocrat, conducted its own investigation, and brought its findings to a class action law firm. The funder was also instrumental in identifying a lead plaintiff and eventually signed funding agreements with approximately 600 individual shareholder plaintiffs. A further 2,300 claimants were unfunded and only came forward to participate in the settlement after it was announced.

Securities fraud and misrepresentations were also at the center of a long-running class action in Israel, which is the case study featured in Chapter 10. In 1995, an investor named Moshe Shemesh filed suit alleging fraud against the majority shareholders of Reichart Industries, several of its officers, directors, accountants and others. A class action was certified in 1996, and soon after, the plaintiff's lawyers negotiated settlements with all but two of the defendants—the company's accountant, who was one of the primary culprits in the fraud, and Dan Reichart, one of the majority shareholders against whom there was very little evidence of wrongdoing. Importantly, distribution of the settlement proceeds reached with the other defendants could not be effected until the case against Reichart and the accountant was either settled or concluded by way of final judgment.

The claims against the two remaining defendants went to trial in 2002, and the court found in favor of the plaintiffs. Dan Reichart appealed on both liability and damages grounds. The plaintiff cross-appealed on the calculation of damages and quantum of lawyer's fees. Shemesh's lead attorney, however, faced a dilemma: should he pursue the appeal and thereby delay distribution of settlement funds to the class, or abandon the claim against Reichart, who consistently refused to settle? The lawyer proceeded with the appeal, and only after three visits to the Supreme Court and strong pressure from the bench did the parties eventually settle the case, some 15 years after it had begun. The prolonged litigation and delayed settlement garnered little benefit for the class. Because class counsel chose to protract the litigation, the class and counsel both received the benefits of the litigation far later than would otherwise be the case.

The final chapter in this part of the book examines two Canadian cases. The first, *Atlas*, focuses on familiar allegations of securities misrepresentations and shareholder losses. The second, *Hislop*, concerns a claim of discrimination on the basis of sexual orientation against the federal government. Both cases illustrate the ways in which the entrepreneurial litigation model affects the initiation, conduct and resolution of class proceedings.

Atlas was initiated in February 2004 as a result of alleged misstatements in its 2001 and 2002 public offerings. Two of the three representative plaintiffs were recruited by the two plaintiffs' firms prosecuting the action. Indemnities against the risk of adverse costs were obtained from Ontario's Class Proceedings Fund because the plaintiffs were not willing to pursue the litigation without such insurance. Several interlocutory motions were argued in the case before it settled in 2008—a few months before the certification motion was to be heard. Although the judge approved the settlement, she agreed with objecting class members that the fee requested by the plaintiffs' firms was not reasonable. Her order discounting the fee was then appealed by class counsel to the Ontario Court of Appeal, which agreed with the lower court judge.

Hislop was a national class action on behalf of approximately 1,000 class members whose same-sex partners paid into the Canada Pension

Plan (CPP) and died between 1985 and 1998. The plaintiff, George Hislop, volunteered to represent the class when he heard that an LGBTQ advocacy group wanted to sue the federal government over discriminatory provisions in the CPP. Hislop did so despite the fact that he would be exposed to adverse costs if the class lost, and he would be precluded from settling his own personal claim if the government offered to do so.

Hislop was the first national class action to go to trial in Canada. The trial took place in 2003 and was a complete victory for the class. In Canada, as in the US, the trial judge awards fees to class counsel when the class prevails. At the time *Hislop* was decided, the Canadian practice was to award a base fee plus a multiple of that base, if the judge believed it was merited. The trial judge in *Hislop* awarded plaintiff's counsel their base fee plus a multiplier of 4.8, the highest multiplier awarded up to that time. Defendants were also ordered to pay adverse costs of almost $2 million. The federal government appealed the trial judge's rulings, and was partially successful at the Court of Appeal and then again at the Supreme Court of Canada. While the case was winding its way through the courts, the government refused to pay any of the CPP benefits that were indisputably owed to the class members, creating a dilemma of both an ethical and economic nature for the plaintiff's lawyers; should they offer to settle the appeals and obtain lower fees so that class members would immediately receive the benefits owed to them by the government, or should they hold on to maintain the potential for higher damages for the class, and greater fees for themselves, at the cost of delaying compensation for class members?

Another dilemma arose regarding the plaintiff's lawyers' fees. Just prior to the fee approval hearing, counsel for the government alerted the plaintiff's attorneys that section 65 of the CPP provided that pension benefits could not be assigned or charged for another purpose. While section 65 was enacted to protect pensioners from ordinary creditors, government lawyers in *Hislop* argued that it also applied to pensioners' lawyers, who sought to deduct their judicially-approved contingency fee from class members' pension arrears or from future payments. Because of the government's challenge, plaintiff's counsel was forced to pursue their clients (the class members) individually to collect their proportionate share of the contingency fee awarded by the judge. The precedent set by the fee issue made future litigation over government entitlements unappealing for class action lawyers, who rely on the certainty and efficiency of payment once a contingency fee is approved.

The case studies provide a rich and nuanced demonstration of the different avenues class actions may take, as initial facilitators later interact with other enablers in an effort to maintain control of the litigation. Plaintiffs, attorneys and funders, both local and foreign, may be involved in prosecuting a class action, and their interaction may be collaborative at times, and competitive at others.

ECONOMIC ENABLERS

As the case studies demonstrate, class actions may be initiated and controlled by various actors—class members (local and foreign), entrepreneurial attorneys, and funders (public and private). We next explore the distinctive characteristics of each of these actors, which allow them to initiate and control class action litigation.

Representative Plaintiffs

Many class actions involve a large number of claims of relatively modest value. If pursued individually, each claim would have a negative expected value, because the cost of litigation would far outweigh the monetary value of the claim. The rational decision in such circumstances is not to litigate. Aggregating claims via a class action or other collective procedure changes the calculus for the group, as the costs and risks of litigation are spread over the group members. However, each class member has a minimal stake in the aggregate litigation, and therefore none has a sufficient incentive to pursue it. This incentive problem is further exacerbated by collective action issues. Even when class members have a sufficient stake in the class action—for example, because their claims have greater value—they would rather take a *free ride* on the efforts and investments of other class members, thus gaining the same benefit without incurring the cost and risk involved in such litigation. In addition to these economic realities, class members are often ignorant of their cause of action, and even if they suspect that they have a valuable claim, they lack the liquidity to pursue it in court.

Yet, initiating the class action may require information which is held by class members only. Even if they do not fathom its legal implications, class members may nevertheless have some information indicating that their interests may have been adversely affected by an act or omission of a potential defendant. Class members may hold the best, and often only, information about their injuries from tortious acts. Initiating a class action in such cases requires class members to come forward and demonstrate their injury. The named plaintiff would then serve the same purpose as the plaintiff in an individual lawsuit. He or she is the representative, or typical, example for courts to grapple with when adjudicating a class action.

The class representative may also help the court in monitoring the class attorney and guaranteeing that he or she fulfills his or her duties to the class. This function requires, though, that the class representative will not only have similar incentives to those of the represented class, but will also have sufficient motivation to effectively monitor the attorney. Unfortunately, these two requirements often conflict. When each class member has small stakes in the litigation, any one of them would have similar interests to those of all the others, yet none may have sufficient resources and incentives to monitor the class attorney.

Depending on their views about which of these functions is most significant, legal regimes have taken alternative approaches to achieve meaningful representation of the class by its representative.

One such approach is to look for class members whose stakes are sufficiently high to justify their investment in initiating the class action and monitoring it. This is the approach mandated by the US Private Securities Litigation Reform Act, which creates a rebuttable presumption that the shareholder with the largest financial stake in the litigation serve as class representative. This Act governed the appointment of the class representative ('lead plaintiff') in the Royal Dutch Shell litigation. In the absence of such legislation in Australia, it has been difficult to convince institutional investors to assume the role of lead plaintiff. In *Multiplex*, institutional investors had most of the claims against the defendant, but none were willing to be the lead plaintiff. Among the possible explanations offered by our interviewees for this reticence were that the business community is small and there is a preference 'to settle things at the club', that institutional investors want to avoid discovery and the adverse costs risk, and that they were not yet familiar with the role of commercial funders in litigation and, in particular, the funders' assumption of the risk of an adverse costs order.

Another approach is to forgo the requirement that the class representative should be a member of the plaintiff class, and instead to require that representation be provided by non-profit organizations, consumer/investor associations or special purpose foundations who represent similar interests outside the class action context. This approach has been favored by civil law jurisdictions that have adopted class action procedures and was the approach that led to the appointment of a special purpose foundation to represent non-US investors in the Royal Dutch Shell settlement proceedings in Amsterdam.

Finally, some commentators have proposed forgoing class representation altogether, preferring scrutiny of the class attorney's adequacy of representation and focusing attention on certification requirements that pertain to the substantive and procedural attributes of the case and the qualifications of the class attorney.

Entrepreneurial Lawyers

More than 80 years ago, Judge Jerome Frank of the US 2nd Circuit coined the term 'Private Attorney General' to describe the statutory authorization of a non-official person to pursue public proceedings to vindicate the public's interest.[1] Since then, the term has often been used to describe the role of private attorneys who initiate and litigate class actions. Indeed, the class action attorney is pursuing public goals, most notably law enforcement and deterrence, by using private litigation. Yet, the class attorney is a mix of public and private, not only in the type of litigation he or she pursues but also in his or her motivation for pursuing it. A distinctive feature of the class action procedure is its potential for enlisting the attorney's private economic incentives, to the benefit of the represented class and the public at large. Hence, the class attorney is not only described as a 'Private Attorney General', but also as a 'Bounty Hunter' and an 'Entrepreneur'.

Aggregation is essential for rendering class members' claims *marketable* for lawyers. The expected return on the lawyer's investment of time and money must exceed his or her opportunity costs. Since complex litigation might entail high fixed costs, aggregation of claims is necessary to provide economies of scale. At the same time, lawyers are potentially good litigation funders. Although they may be required to make substantial monetary investments in payouts for investigatory work, complex pretrial procedures, and expert reports and testimony, their main investment is often their time and effort. This relaxes their liquidity constraints, compared to other litigation enablers. They have the necessary expertise and experience to evaluate the risk and value of a lawsuit, and they can diversify their investments among different class actions. Thus, the combination of scale economics, with a bounty or contingent fee mechanism, renders attorneys prominent and effective candidates for pursuing public goals, through the class action, for private gain.

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1 *Associated Industries of New York State, Inc. v. Ickes*, 134 F. 2d. 694, 704 (2d Cir. 1943).

Indeed, some of the cases studied in this part demonstrate the prominent role played by attorneys in initiating class actions and litigating them. They feature the complexities that may arise due to interrelations between the class and the attorney (*Hislop*), among attorneys competing for control of the class (*Royal Dutch Shell/Transport*) or sharing carriage of the action (*Atlas*), and between attorneys and private funders (*Multiplex*). Whether attorneys fully control the class action or not, their enabling function in each of the case studies cannot be overstated.

This framework, however, is subject to two significant critiques. One, the *external* critique, is based on the doctrinal, constitutional and often cultural aversion in various legal systems to lawyer-initiated litigation. The other, the *internal* critique, is based on the economic theory of *agency*, which recognizes the adverse implications created by the divergence between the class attorney's private interests and the interest of the class and the public at large. In fact, both critiques are driven by the absence of a significant plaintiff-client who may initiate the lawsuit and monitor its progress.

The external critique is demonstrated by the doctrines of barratry, maintenance and champerty. These doctrines prohibit the lawyer from initiating a lawsuit or financing it for his or her client. The practice of entrepreneurial lawyering in class actions stands in stark conflict with these doctrines. It therefore comes as no surprise that many legal systems do not allow lawyer-initiated class actions, and even when allowing them, proscribe the use of contingency fees for class attorneys, or prohibit lawyers from fronting litigation expenses for the class. Objections in such legal systems to attorney-driven litigation seem to be rooted in a strong resistance to the common perception of hyper-litigious Americans. Although empirical data do not support this perception, it has taken root in many parts of the world, where the 'US-style' class action is considered to be emblematic of the dangers of incentivizing lawyers to litigate. As a formal matter, American lawyers cannot initiate class actions themselves, but they may search for candidate class representatives for potential class litigation. As explained further below, in American class actions, judges award attorney fees when the class prevails, which by law may reflect the risk the class counsel took on to represent the class.

The internal critique maintains that attorneys do not fully realize the interests of class members—their clients—because these client interests are misaligned with the attorneys' own private interests. This divergence is created by the nature of entrepreneurial attorney litigation, in which the attorney bears the *full* costs and risks of litigation, yet enjoys only *part* of the stakes. It is often suggested that this divergence results in the class attorney's inclination to invest too little in litigating the case, and to settle for too little and too early, when these decisions are evaluated from the represented class' perspective (Hensler et al., 2000, 79). However, as the Israeli case study of *Shemesh* demonstrates, agency does not always play out the way economic models predict. In a case that was completely controlled by the lead attorney, that attorney decided to pursue litigation for an additional ten years after most defendants had settled. This suggests that he understood his duties toward the represented class as requiring him to litigate the case vigorously and decline settlement offers he deemed inappropriate.

Whereas agency problems are thought to be mitigated in individual litigation by client monitoring and by attorney bonding through market reputation, these mechanisms are often absent in attorney-initiated class actions (Macey & Miller, 1991, 19–22) where the client, whether it be the class as a whole or the class representative individually, does not select the attorney and rarely has a sufficient stake to justify monitoring her performance. It is this lack of a significant stake in the litigation that perhaps explains why the representatives in *Atlas* would have agreed to increase their attorneys' contingency fee retroactively, on the eve of the settlement approval hearing.[2]

Thus, although attorneys enjoy inherent advantages in funding and litigating class actions, many legal systems are reluctant to entrust the public cause to their private hands. Legal regimes diverge in the incentives they allow class attorneys, mainly whether they allow for their fees to be contingent upon litigation success, and in the selection and monitoring mechanisms they employ to control against attorneys' agency problems.

Commercial Funders

A striking feature of class action litigation in recent years has been the increasing presence of commercial litigation funders as class action

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[2] In Canada, representative plaintiffs sign retainer agreements with class counsel at the outset of the litigation, setting out the proposed contingency fee (as a percentage of the class' recovery, a base fee and multiplier, or some combination of both). This agreement is taken into consideration by the judge who ultimately sets the fee when and if the case is successfully concluded. In *Atlas*, the representative plaintiffs originally signed fee agreements in 2004 providing for a 25 percent contingency fee; four years later, they agreed to a 30 percent fee or a base fee times a multiplier of 4, whichever was greater.

enablers. Companies that are in the business of assuming the substantial financial risks of a class action in exchange for a share of any damages awarded are now a permanent feature of the class action landscape in Australia, Canada and increasingly Europe, although less so in the US and Israel.[3] Two Australian authors have reported the view of an experienced litigation lawyer that 'the capacity for plaintiffs to bring an equality of arms to large scale litigation through [commercial litigation funding is] one of the most significant changes in the litigation landscape' in more than 30 years (Watson & Donelly, 2014, 27).

Whether and to what extent there are commercially funded class actions in any jurisdiction will depend on that jurisdiction's costs and fees rules and practices. Costs shifting and the related risk of an adverse costs order, prohibitions on lawyers' contingency fees, the lack of any 'after the event' insurance, and the unavailability of legal aid or any public fund to support class action litigation are all factors that create a gap in class action financing. In Australia, for example, all of these factors are present, which is why entrepreneurial commercial funders now occupy a central place in class action litigation. Their role has also been facilitated by positive court decisions that have endorsed commercial funding of class actions[4] and by entrepreneurial lawyers who have been willing to change their litigation business models. In the US, in contrast, the American fee rule (each side bears its own costs), legal acceptance of contingency fee agreements in individual litigation and judicial fee awards that recognize risk in class actions mean that there has been far less demand for third-party funding of litigation. Large plaintiff law firms with healthy credit lines dominate the class action landscape.

This is not to suggest that the entry of commercial litigation funders into class action litigation has been smooth. In Australia, the country that has led the way in private commercial funding of class actions, the role of commercial funders has been hotly contested, from:

> challenges on the basis of maintenance, champerty and abuse of process, to the permissibility of 'closed classes' … , to the question whether various existing financial regulations apply to litigation funding arrangements (Cameron & Kalajdzic, 2014, 5).

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[3] *See* Cameron & Kalajdzic, 2014, and Kalajdzic, Cashman & Longmoore, 2013, for an analysis of the role of commercial litigation funders in class actions in these three jurisdictions.

[4] *Campbell's Cash and Carry Pty Ltd v. Fostif Pty Ltd* [2006] HCA 41 ('*Fostif, HC*'); *Fostif Pty Ltd v. Campbell's Cash and Carry Pty Ltd* (2005) NSWCA 83; *Multiplex Funds Management Limited Pty Ltd v. P. Dawson Nominees Pty Ltd* [2007] FCAFC 2000.

In the US, common law strictures against maintenance and champerty have been abandoned by some states but not all, and yet third-party funding of class actions is still uncommon.

While some of the central questions about commercial funding of class actions are similar across jurisdictions, the answers vary just as the legal cultures and the legal architectures and institutions of those jurisdictions vary. Australia and Canada have, for example, both grappled with the question of the degree of control that commercial funders should be allowed to have in the litigation they are funding, but their answers differ. In *Fostif*, the High Court of Australia endorsed a relatively broad degree of funder control.[5] In contrast:

> [l]ong-standing principles related to the independence of counsel have informed Canadian courts' opposition to [commercial funding] contracts that would provide the funder with control over the litigation (Kalajdzic, Cashman & Longmoore, 2013, 145).

Another challenge common to all jurisdictions in which commercial funders are operating is how best to regulate the commercial funding industry. A dominant theme in many discussions about regulation is concern about consumer protection.[6] In Australia, the courts were of necessity the first regulators, because the industry was new and existing financial and securities regulations had not been drafted with commercial litigation funding arrangements in mind. This judicial regulatory role is evident in *Multiplex*; much of the interlocutory litigation in that case arose because of the presence of a commercial funder. The courts were called on to determine whether the funding arrangement was a 'managed investment scheme' under corporate legislation and whether requiring class members to sign an agreement with the funder was inconsistent with the opt-out nature of Australia's class action regime. What has evolved in Australia is a combination of regulatory sites—judicial, legislative and self-regulation by funders. All of the regulation in Canada,

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5 *Fostif, HC*, n. 23.

6 In the Australian class action context, defendants have been the prime agents of court challenges to the participation of litigation funders. While consumer protection has been one of the arguments advanced, it is safe to assume that the capacity of commercial funding to shift the traditional balance of power in litigation is also a key reason for most of the challenges that have been advanced by defendants.

however, is still occurring by way of judicial scrutiny.[7] In the US, regulation of third-party funding is still under debate.

The 'access to justice' value of commercial litigation funding is another frequently debated topic.[8] The risks assumed by commercial funders, especially in cost-shifting jurisdictions, require them to do a robust risk analysis. They are interested in cases with a high prospect of success and significant money damages. This excludes much public interest litigation. Among those cases that funders are willing to take on, however, there will be individual and institutional claimants who have suffered financial loss as the result of the defendant's misconduct. The availability of commercial funding enables their meritorious claims to be litigated. It may be limited access, but it is access.

Public Funders

In addition to commercial firms, the state may also facilitate class action funding by creating public funding entities, such as in two provinces of Canada, as well as in Israel.[9] In many respects, commercial and public funding models are similar: both seek to invest in class actions that have a high probability of success, for a return on investment based on the monies recouped in the action. They both provide indemnities against adverse cost awards, and both purport to increase access to justice for representative plaintiffs and their lawyers, in situations where counsel are not willing to serve on a purely contingent basis with respect to both time and disbursements.

There are, however, important differences. While commercial financiers invest with a view to making a profit that can be distributed to their investors, public funders seek to make a return that can then be used to finance other cases. In selecting cases to fund, profit maximization is not the only consideration for public funders; rather, they are statutorily required to consider the public interest when assessing applications for

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[7] *See* Kalajdzic, Cashman & Longmoore, 2013, 141–145, for a discussion of the regulation of commercial litigation funding in Australia, Canada and the United States.

[8] For a fuller discussion of this issue, *see* Watson & Donelly, 2014; Cameron & Kalajdzic, 2014; Kalajdzic, Cashman & Longmore, 2013.

[9] *Quebec*: le Fonds d'aide aux recours collectifs, available at http://www.farc.justice.gouv.qc.ca/. *Ontario*: Class Proceedings Fund, available at http://www.lawfoundation.on.ca/class-proceedings-fund/. *Israel*: The Class Action Fund, available at http://index.justice.gov.il/Units/YeutzVehakika/TovanotYitzugiyot/Pages/TovanotYitzugiyot.aspx

funding. While both public and private funders seek to be kept informed of developments in the funded action, public funders have no input in the cases; conversely, where judicially permitted, commercial funders may seek some control of the litigation strategy. Commercial funding firms have the flexibility that contractual relationships provide, so that they can, for instance, limit their exposure to adverse costs[10] or provide for a cap or sliding scale on their percentage return. Public funders, on the other hand, are constrained by their enabling statutes and regulations; in the case of Ontario's fund, for example, exposure to costs is limitless, and the ten percent levy on successful actions is fixed.[11]

Although budgets can be constrained in both commercial and public funding models, commercial funders' budgets may be more influenced by investors' confidence in the perceived viability of the action, while public funders have the more rigid limitations of government budgets. This is more true in Israel than it is in Canada, where the self-funded model provides opportunities for growth that do not depend on the largesse of government. Both the Quebec and Ontario funds are self-perpetuating in that they impose a levy on successful cases. The Quebec government also guarantees the liquidity of that province's fund.[12] Ontario's fund was created in 1993, at the same time that class proceedings legislation was enacted, with seed money of $500,000. Since then, it has grown exponentially, with no additional government funding, to a balance of over $19 million at the end of 2014.

Although there is no similar public funding for class actions in the US, where the publicly-funded Legal Service Corporation was prohibited from funding class actions by a 1999 statute, the leading US corporate law firms assist the prosecution of public interest class actions by providing legal services *pro bono*. Private lawyers frequently work on such cases in tandem with lawyers from non-governmental organizations that receive financial support from law firms and individual lawyers. In effect, *pro bono* legal services operate as a quasi-public source of funding. While not subject to public regulation, *pro bono* lawyering is subject to private law firm decision-making, which is responsive both to the firms' financial circumstances and to concerns about the effects of specific legal engagements on their market reputation. Corporate law

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[10] *See* for example *Baynes v. Kinross* 2013 ONSC 4974, where the commercial litigation funder limited its exposure to costs to $1 million in respect of the certification motion and $5 million thereafter up to the conclusion of the common issues trial.

[11] Class Proceedings, O Reg 771/92, s. 8(4)(c).

[12] Act respecting Class Actions, s. 44.1.

firms are unlikely to provide *pro bono* support for litigation against corporate defendants, and plaintiff firms may be unable to assume further financial risks given the nature of their practices.

INSTITUTIONAL VARIABLES THAT AFFECT THE SELECTION OF THE ENABLING AGENT

Representative plaintiffs, entrepreneurial lawyers, and private and public funders are all potential class action enablers. Each may initiate the class action and then control (to varying degrees) its litigation. Comparisons among different legal regimes show that the dominant class enabler in each is different. Before examining who the dominant enabler is in four jurisdictions where the cases presented in this Part arose, we briefly review two economic institutional factors that may influence who the enabler may be in each specific legal regime—attorney contingency fees and cost-shifting rules.

Attorney Contingency Fees

Monetary class actions create a common fund, whose benefits extend to the whole class.[13] The common fund is created either by a court decision when the class prevails, or by a settlement. The class attorney's fee may then be paid out of this common fund, thus allocating the proceeds from the lawsuit between the class and the attorney. Since the class is dispersed and most class members do not actively approve the lawsuit, and often are not even aware of it, the attorney may not collect a fee higher than the common fund. Hence, the attorney's fee must be contingent on winning the class action, or on settlement. A non-contingent fee, which is paid independent of the suit's outcome, is not feasible in opt-out class actions.

The attorney's contingent fee may be set as a percentage of the common fund, in which case it is *output* based, and inherently contingent upon winning the case or settling it. Alternatively, the attorney's fee may be based on the hours spent by the attorney, in which case it is *input* based. In the US, when this latter fee structure is used, it is called a *lodestar* fee.[14]

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[13] We discuss below the absence in Australia of a 'common fund' approach as that term is understood in Canada, the Unites States and Israel.

[14] Klement & Neeman, 2004, 109; Conte, 2014, § 2:3, 2:6; Hirsch & Sheehey, 2005, 72–75.

Two implications follow. The first is immediate: any legal regime that bans contingent attorney fees, whatever form such a fee may take, is effectively ruling out the possibility of attorneys as class enablers.[15] To facilitate class actions, such a regime must therefore allow for public or private class action funding that pays the attorney's non-contingent fee.

The second implication is more nuanced. Allowing the attorney fee to be contingent is not sufficient to induce lawyers to initiate and litigate class actions. To do so, the fee must be larger than the lawyer's reservation (or alternative) fee for her time investment, assuming such investment is reasonable given the merits of the case. Since the fee is contingent upon winning the case or settling it, there is always some risk (and sometimes a significant risk) that the defendant will prevail and the attorney will earn no fee. The contingent fee must therefore compensate the lawyer for this risk. To demonstrate this point, suppose that the attorney's reservation fee is 100, and the risk of not earning any fee in the class action is 0.5. The attorney must be paid 200 in case of settlement or winning. Only then would his expected (mean) fee be 100 (0.5x200). If the attorney is paid a lower fee, then he would be better off not litigating the class action. Hence, to facilitate entrepreneurial lawyering in class actions, the fee paid must be higher than the actual value of the attorney's time input. This is often the case when the fee is set as a percentage of the common fund. When the fee is hourly based, a multiplier or risk premium must therefore be applied.

More generally, the contingent fee must compensate the attorney for her costs of investigating the class action and litigating it, and for the risk of losing it. Any regulation of the attorney's compensation would limit the types of class actions filed, and the quality of attorneys filing it. The lower the maximum fee, the more difficult it would be for attorneys to pursue complex cases, and the less inclined would the best attorneys—who have the highest reservation fee—be to file and litigate class actions.

Cost-shifting

The cost barrier to litigation in some parts of the world, including jurisdictions discussed in this Part of the book, has two components: the cost of one's own legal services, and the potential cost of paying the opposing parties' fees if one is unsuccessful in the litigation. Cost-shifting has a long history outside the US and serves two fundamental

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15 A limited exception is the early role of Australian class action lawyers, which we discuss below.

purposes: deter wasteful steps in litigation and unmeritorious lawsuits, and at least partially compensate the successful party for costs incurred.

Not surprisingly, the impact of the compensation and deterrence functions of cost-shifting is amplified in mass litigation. As the cost of prosecuting or defending large, complex claims mounts, so, too, do the disincentives in initiating them or risking judgment at trial. Where the representative plaintiff and not the class is liable for adverse costs (as is the case in many of the case study jurisdictions), the individual plaintiff's exposure to the risk of paying a successful defendant's costs creates a significant barrier to justice. After all, such costs, which may run into the hundreds of thousands of dollars, will inevitably dwarf any award the individual plaintiff might hope to recover.[16] No rational person would expose himself or herself to such risk. As one Ontario judge put it, the 'grim reality is that no person in their right mind would accept the role of representative plaintiff if he or she were at risk of losing everything they own'.[17]

To overcome this barrier to justice and ensure the availability of representative plaintiffs, systemic responses have evolved. One is the practice among some Canadian plaintiff lawyers to indemnify their clients against adverse costs. The willingness of lawyers to 'self-insure' depends upon their confidence in the case, business arrangements at their firm and the general state of the economy. However, in some jurisdictions (for example, Israel) such indemnification is considered illegal. A second reaction to risks posed by cost-shifting is the creation of funding mechanisms, either of a public or a commercial nature, from which plaintiffs obtain an indemnification against costs. Although commercial litigation funders operate even in jurisdictions where parties are not subject to cost-shifting, the type and cost of funding arrangements can vary substantially as a result of the risk of adverse costs. Finally, a third response to this problem is to increase the incentive payment to class representatives, to afford them sufficient compensation for their risks, in case they win or settle the litigation. This is the response taken by the Israeli law. In contrast, in Canada and the US, incentive payments to class representatives are limited out of fear that more generous payments would create a conflict between the representative and other class members.

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16 In Ontario, the average costs award to a successful defendant falls in the range of $300,000: *Dugal v. Manulife Financial Corp.*, 2013 ONSC 6354 at para. 5.

17 *Dugal v. Manulife Financial Corporation*, 2011 ONSC 1785 at para. 28.

There is considerable debate about the utility of maintaining the cost-shifting rule in class action litigation. The need for litigation deterrence in mass litigation can sometimes be overstated, particularly in jurisdictions where plaintiffs' lawyers operate on a contingency fee or other speculative basis. After all, even without the possibility of paying the successful party's legal costs, the risk of prosecuting lengthy litigation without any fee recovery can be sufficient to dissuade lawyers from taking on unmeritorious cases. Nevertheless, the specter of frivolous class actions, launched simply to blackmail defendants, has persuaded some governments to retain cost-shifting rules for class actions.[18]

The compensation function of adverse costs awards may be more important in class actions than in other litigation, despite the fact that it is usually the attorney, not the successful litigant, who is being compensated. The historic role of compensation or indemnification of a successful party is largely inapplicable in class actions, where the plaintiff has not paid or been billed by her lawyer. The lawyer, however, has incurred disbursements and committed significant resources to representing the class. It is the lawyer, therefore, who seeks compensation from the unsuccessful defendant; the class members' access to justice is indirectly facilitated by way of a costs order to the lawyer.[19] In addition to making the lawyer funding the plaintiff's lawsuit whole, costs awards paid as a result of interlocutory steps in the proceeding can become an important source of ongoing funding for the law firm, paying experts and other disbursements throughout the case.

Allowing contingency fees in class actions all but guarantees that entrepreneurial lawyers will be the primary enablers of class actions. Yet, the existence of cost-shifting rules complicates this dynamic. If representative plaintiffs bear the risk of cost-shifting, they must also be compensated for this risk, which increases the overall burden on the class; alternatively, if lawyers bear these costs then they must either become even more risk-tolerant, obtain a higher fee proportionate to the risk assumed, or obtain third party indemnities. Failure to secure any of these solutions would expose representative plaintiffs to the unacceptable

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18 There are references to this line of thinking in the debates leading up to Ontario's enactment of its class proceeding statute: Hansards, 12 June 1990 at 1739 (C. Harnick).

19 The 'fiction' of the plaintiff paying or receiving costs was exposed by Justice Paul Perell in a lengthy decision on costs: *McCracken v. Canadian National Railway Company*, 2010 ONSC 6026, reversed on other grounds 2012 ONCA 445.

risk of bankruptcy if the lawsuit proves unsuccessful, without a countervailing benefit, and might therefore spell the demise of the class action regime as a whole. At a minimum, cost-shifting complicates the search for a suitable representative plaintiff; in *Atlas*, the action was delayed as a result of the difficulties faced by counsel in locating a suitable investor who was willing to be named as a representative, and only then after an indemnity was obtained for him, at his insistence, from Ontario's Class Proceedings Fund. In *Multiplex*, efforts to identify a suitable institutional investor as a lead plaintiff failed, although those investors had about 95 percent of the claims against Multiplex. One of the reasons for their reticence was the fear of an adverse costs order. In contrast, in the US, in the absence of cost-shifting, pension funds (and their lawyers) competed avidly to be appointed lead plaintiff in the *Royal Dutch Shell/Transport* class action.

MAPPING THE FRAMEWORK

United States

The modern American class action was adopted in 1966. One result of the 1966 Rule was to facilitate class actions for money damages (Hensler et al., 2000). All but one state in the US have adopted class action rules modeled on the federal rule.

Private civil litigation in the US is facilitated by the 'American fee rule' and by the availability of contingency fees. Unlike in most other jurisdictions, in most US litigation each side must bear its own costs, win or lose. With few exceptions, the same fee rules prevail in class actions.

The prevalence of contingency fee representation has contributed to the development of a vibrant risk-tolerant plaintiff bar. Successful plaintiff law firms maintain an inventory of cases such that fees from successfully concluded cases provide up-front funding for new cases. The most successful firms have substantial lines of credit from commercial banks to smooth out cash flow. Class counsel are not permitted to enter into contingency fee agreements with class representatives, but the contingency fee business model works equally well for class actions, in which judges award fees for successful representation. Whether applying the percentage of fund approach or the lodestar approach (see below), the result is that plaintiff counsel are rewarded in proportion to the amount they secure for the class, and all class members contribute proportionately to paying the attorneys' fees.

Representative Plaintiffs: As a result of the American fee rule neither the representative plaintiff nor other class member bears any risk of adverse costs. As a result of equitable fund doctrine, if the class prevails, the representative's share of attorney fees and expenses will be the same as any other similarly situated class member. Perhaps as a result, a class member's financial wherewithal has little consequence for being approved by the judge as a class representative. In certifying a class, the judge must find that a proposed representative is typical of other class members and will provide adequate representation. But adequacy of representation has long been interpreted as applying to class counsel's ability to effectively represent the interests of the class, including having resources to prosecute the action.

Because they bear no adverse cost risk nor disproportionate responsibility for class counsel fees, class members have little or no financial disincentive for serving as class representative—but also little incentive for monitoring the class attorney. Monitoring might be incentivized if class representatives received special payment for their services (Nagareda, 2006), but because of fear that incentive payments might create conflicts of interest between the class representative and other class members, they are strictly limited in class actions generally (Eisenberg & Miller, 2006) and forbidden altogether in securities class actions.

Somewhat anomalously, under the Private Securities Litigation Reform Act, the financial stakes in the litigation of candidates for class representative is the primary basis for their being selected as lead plaintiffs by the trial judge. The rationale is that the class member with the greatest financial interest in the litigation will have the greatest incentive to monitor the class attorney. In effect, the lead plaintiff provision substitutes for paying meaningful incentive payments to the class representative.

Class Attorneys: The growth of the plaintiff bar that contingency fee representation enabled has led in turn to the development of plaintiff firms that specialize in mass and class action litigation. The Multi-District Litigation (MDL) procedure that consolidates claims arising out of a common set of facts and law and assigns them to a single judge created the possibility that a judge would find herself dealing with dozens or more attorneys all representing plaintiffs in the same litigation at the same point in time. To rationalize this process, MDL judges began appointing lead plaintiff counsel and Plaintiff Steering Committees (PSCs) to guide the litigation. To assure quality and efficiency of representation, judges tended to appoint the same national and regional law firms to serve on these committees. These positions are widely sought after as they offer an opportunity to shape the litigation, including negotiating group-wide settlements. Often lead counsel and PSC members receive special fees on top of whatever contingency fees they may have negotiated with their clients. As judges became comfortable with the idea of appointing lead counsel in mass non-class actions it seemed reasonable for them to also appoint class counsel. Now the judge's responsibility to appoint class counsel is enshrined in the class action rule. Lawyers compete vigorously for class counsel appointment, because whatever firm is appointed will, if successful, receive the fee award. A large class action will require at least several million dollars to prosecute and complex cases may cost more. The class counsel firm must lay out all these funds without any promise that they will be compensated in the end.

Third-Party Funders: As commercial funding has entered the US market, it has largely avoided class action litigation (Hensler, 2014). This may be in part a strategy calculated to disarm corporations (the usual class action defendants) that offer potentially attractive targets for funding commercial litigation. It may also reflect uncertainty on the part of these relatively new market actors about how to assess class action litigation risk in the US. The recent line of US Supreme Court decisions making it more difficult to obtain class certification may also diminish third-party funders' appetite for investing in class actions. Notwithstanding this general pattern, there are examples of complex high-value class actions, chiefly in the antitrust domain, that have attracted outside investment. And some law firms have provided funding to lead counsel firms in mass and class actions in return for a share of eventual fee awards (Goral, 2016).

There is no public institutional funding for class actions in the US, but leading corporate law firms have contributed substantial time pro bono to prosecuting public interest litigation and also have contributed to non-governmental organizations that often lead such litigation.

Canada

Class actions in Canada have existed in Quebec since 1979 and in English-speaking Canada since 1993. All but one province and territory now have a class action statute. All statutes require the court appointment of a representative plaintiff in whose name the lawsuit is filed by counsel. All jurisdictions allow lawyers to act on a contingency fee basis, with the ultimate fee to be approved by a judge. Roughly half of the statutes maintain the cost-shifting rule in class action litigation, with the representative plaintiff (not the class) liable for such costs.[20] The other provinces specifically provide that the usual two-way cost rule is suspended in class actions.[21] In terms of opting in and out, all statutes operate on an opt-out basis, at least for their own residents, with some also permitting out-of-province residents to be included in the class on the same basis.

Given these institutional variables, three types of enablers facilitate class action litigation in Canada: representative plaintiffs, class attorneys and public funders.

Representative Plaintiffs: Representative plaintiffs are the least influential economic enablers in Canadian class actions. Individual plaintiffs do not fund class actions, they are not responsible for paying their own lawyers' fees, and they are almost always indemnified against the risk of adverse costs. There is some empirical and anecdotal evidence that most class actions are initiated by class counsel, not class members.[22] The two Canadian case studies discussed in this book were both initiated by the lawyers, not the representative plaintiffs.

Despite their lack of economic influence, representative plaintiffs are a necessary feature of the Canadian class action regime. Indeed, in both *Atlas* and *Hislop*, much effort was expended to identify and persuade suitable individuals to represent the class. The representatives did so without the guarantee of any benefit over and above what they would receive as passive class members. But for their willingness to stand as representatives, the class actions could not have been commenced. Still, for the reasons explored above, there is a serious debate about the extent to which representative plaintiffs actually exercise any influence over the litigation or effectively monitor the conduct of the class attorneys. Some judges have expressed the view that representative plaintiffs are usually

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20 Ontario, Alberta, New Brunswick and Nova Scotia apply their normal 'loser pays' rules with respect to costs in class actions. *See* Winkler et al., 2014, 368.

21 British Columbia, Manitoba, Newfoundland, Saskatchewan and the Federal Court have modified no-way costs rules for class actions. Winkler et al., 2014, 366.

22 A 2009 survey of 13 leading class action firms in Canada revealed that less than 25 percent of the reported 332 cases were initiated by clients. Kalajdzic, 2009, 20.

figureheads.[23] The courts' endorsement of client recruitment, counsel indemnification of the client, and judicial insistence that the client in a class action is not just the representative plaintiff but the class itself, all serve to mitigate whatever authority the individual representative theoretically possesses by virtue of the statutory requirement.

Class Attorneys: The availability of contingency fees, sometimes at multiples of the lawyers' usual hourly rates, has created a decidedly entrepreneurial class action bar. Fees in the millions of dollars are routinely awarded.[24] While some lawyers choose to pursue a particular class action for ideological reasons, most decide to initiate a suit because of the likelihood of success coupled with the potential size of the damage award.[25] The bigger the damage award or settlement, the bigger the contingent fee. The economic incentive created by contingency fees is what drives class actions in Canada. Just what constitutes an adequate incentive, however, is the subject of some debate. In *Atlas*, the case management judge and then the Ontario Court of Appeal agreed that a $6.3 million fee in a $40 million settlement (or 2.6 times the lawyers' usual hourly rates) was an adequate incentive.[26] The plaintiffs' lawyers in the case, however, who had requested approval of a $12 million fee, thought otherwise.

Public and Private Funders: As described above, public funding entities exist in Ontario and in Quebec. These funds provide an indemnity against adverse costs to those plaintiffs whose applications are approved. In exchange, in Ontario the Fund receives 10 percent of the class' recovery, net of the lawyers' fees. In *Atlas*, this amounted to a levy of approximately $3 million. In Quebec, the rate of return varies. Commercial litigation funders have provided indemnities to representative plaintiffs in a small number of cases in Ontario for slightly less than a 10 percent return (Kalajdzic, Cashman & Longmoore, 2013). Still, the predominant source of insurance against adverse costs remains the plaintiff's law firm. With far more to gain than any individual class member, and far more to lose (both in terms of no fee, and liability for costs to the successful defendant), entrepreneurial lawyers are unquestionably the most important economic enabler of class actions in Canada.

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23 One judge interviewed for one Ontario study stated that there 'are cases where it's a joke, frankly, to think the client is doing anything. The client was recruited and just accepts instructions'. Kalajdzic, 2011, 17.

24 For an empirical analysis of fees, *see* Alarie & Flynn, 2014.

25 Kalajdzic, 2009, 22.

26 Kalajdzic, The engine that drives, infra Chapter 11 at ff. 41 and accompanying text.

Australia

In the almost 25 years since the modern class action was introduced in Australia, entrepreneurial lawyers and commercial litigation funders have been the economic enablers of class actions. To these two class action enablers we can add a third, uniquely Australian, enabler: the 'closed class'. In the context of a commercially funded class action, the closed class mechanism limits membership in the class to those who have signed an agreement with the funder. In exchange for taking on the considerable risk of a class action, funders want the benefits that the closed class provides: elimination of the 'free rider' problem and greater certainty as to the number of claimants and the likely return for the funder should the action be successful. This private contract approach to funding arrangements is necessary because, unlike Canada, Israel and the US, there is not yet a 'common fund' option in Australia such that class counsel can count on a judge to award them fees and expenses if the class prevails, which will be allocated as a share of the total amount defendants pay to resolve the litigation. There are signs of a shift, but until that shift occurs commercial funders will continue to use closed classes in this way to manage their risk.[27]

Entrepreneurial Lawyers: Unlike their counterparts in other jurisdictions, who were encouraged to be entrepreneurial because of the availability of contingency fee arrangements, early class action lawyers in Australia were forced to be entrepreneurial because of the unavailability of contingency fee arrangements or any other funding vehicle to nurture a nascent class action regime. Prior to the entry of commercial funders into the market, a few Australian law firms were willing to take on the very significant financial risk of large class actions. They did this on a 'no win, no fee' basis, without the advantages provided by contingency fee arrangements or a 'litigation war chest', and in circumstances in which costs-shifting and the liability of lead plaintiffs for costs made it very difficult to find willing lead plaintiffs (Murphy & Cameron, 2006, 432–434). Notwithstanding these initial obstacles, they demonstrated that class action litigation, effectively managed, could be lucrative. This encouraged commercial funders, who had traditionally limited their activity to insolvency cases, to develop new business models to fund class actions. Those funders might eventually have entered the market in

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27 A request to make a 'common fund' order was rejected by the court in *Blairgowrie Trading Ltd v. Allco Finance Group Ltd* [2015] FCA 811. For a consideration of the arguments in favor of a common fund approach in Australia, *see* Hoffman-Ekstein, 2013.

any event, but the initial willingness of some plaintiff lawyers to 'fund' complex class actions probably expedited that entry.

Commercial Litigation Funders: Encouraged by the successes of some pioneering entrepreneurial lawyers and bolstered by favourable court judgments,[28] commercial funders stepped in to fill the huge funding void in Australian class actions. They are now a dominant presence in the Australian class action landscape and the main class action enabler. They thrive because, unlike Australian lawyers, they are able to fund litigation in exchange for a percentage of the damages award or settlement sum.

One of the early criticisms of the Australian funding market was that there were too few players and, therefore, too little competition. While there is still room for growth, the number of funders has increased and now includes both Australian and overseas funders. There are at least 11 active funders in the Australian class action market—six from Australia, two from the UK, and one each from The Netherlands, Singapore and the US (King & Wood Mallesons, 2014). This globalization trend works both ways; several Australian funders are active in overseas markets.

While legislative scrutiny has increased in recent years, funders are still operating in what can accurately be described as a 'light touch' regulatory regime. Courts were the first 'regulators' and dealt with a number of early challenges to the very existence and legitimacy of litigation funding arrangements. There has been a gradual shift in the site of regulation away from the courts to the legislature. In July 2013, legislative amendments came into effect that exempt litigation funders from the need to hold an Australian Financial Securities License but require them to have in place suitable practices to manage conflicts of interest.[29]

Perhaps the biggest question about the future development of commercial funding of Australian class actions is whether Australian courts will endorse the common fund approach. If they do, there will be a significant change in Australia's class action landscape. This is discussed below.

The 'Closed Class': 'Closed' or limited classes are those defined to limit the class to fewer than the total number of people who have suffered the alleged loss. While closed classes were used in the early days of Australian class actions, they remained uncontroversial until the *Multiplex* decision. The *Multiplex* class was limited to people who had signed a funding agreement with ILF, the Canadian commercial funder. Having

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28 *Fostif, HC* and *Multiplex*, n 23.

29 *Corporations Amendment Regulation 2012 (No 6) (Cth)* and Australian Securities and Investment Commission Guide 248 (ASIC Guide).

entered the class action market, funders demanded as the price for staying there the increased certainty provided by a class limited to those who had signed a funding agreement. This particular use of the closed class was challenged by the defendants in both of our case studies, *Multiplex* and *Aristocrat*, and finally resolved in *Multiplex*.

One of the bases on which the defendants in *Multiplex* challenged the funding agreement was that any clause limiting the class to those who had signed an agreement with the funder was contrary to the opt-out nature of Australia's class action regime. When that regime was introduced for proceedings in the Federal Court of Australia,[30] it was intended to be an opt-out regime. In preferring the opt-out approach, legislators had accepted the recommendations of the Australian Law Reform Commission (ALRC) in its *Grouped Proceedings* report.[31] The authors of that report recommended an opt-out regime for access to justice reasons.[32] The Attorney-General agreed, stating that the opt-out approach was 'preferable on grounds of both equity and efficiency'.[33]

The opt-out nature of the Federal Court of Australia class action regime was generally accepted in the first 10 to 15 years of its operation. During that period, however, classes were defined in various ways that limited those who would benefit from and be bound by any judgment to fewer than the total number of potential claimants.[34] These practices continued without adverse judicial comment or defendant objection and, often, with explicit judicial approval and encouragement.

This is the class actions landscape in which commercial litigation funders began to assume a dominant presence. Funders take on the cost and risk associated with complex class action litigation in a cost shifting jurisdiction and take a percentage of the damages recovered, in the 20–45 percent range. In exchange, they require as a condition of class membership that members sign a funding agreement with them.[35] Their attempt

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30 Federal Court of Australia Act 1976 (Cth) Pt IV ('Federal Court Act').

31 LRC Report No 46, 1988, para 101. They did not, however, accept LRC advice about the need for lawyer contingency fees and a public fund of the kind operating in Ontario.

32 LRC Report No 46, 1988, paras 104–108 and 126–127.

33 Commonwealth, Parliamentary Debates, House of Representatives, 14 November 1991, 3174 (Michael Duffy, Attorney General).

34 For a detailed study of these cases, *see* Morabito, 2007.

35 In the absence in Australia of a common fund approach, funders will continue to demand closed classes as the price of assuming the financial risk. However, commercially funded open classes will be possible if courts accept, as they are being asked to do, that they have the discretion to approve a common

to define a class in this way was challenged by the respondents in *Multiplex*.[36]

The Federal Court first instance and appeal judges disagreed with the arguments advanced by Multiplex and confirmed the appropriateness of the funder criterion as a prerequisite to class membership. In doing so the court relied less on overarching principles about the intent of the legislation and more on a close reading of the relevant provisions. They concluded that the words 'as representing some or all of them' in section 33C, which is the provision that sets out the threshold requirements for a class action, contemplated a class composed of fewer than all of the possible group members.[37] Such 'closed classes' are now commonplace in commercially funded class actions in Australia and, as a result of *Multiplex*, no longer contested.

Interviews we conducted confirmed that there are some Australian class actions that would not have been brought but for the availability of commercial funding (and see Watson & Donelly, 2014). They also confirmed that the closed class has enabled Australian class actions; by providing certainty for funders, it encourages them to stay in or to enter the market.

A looming question for commercial funding in Australia is whether Australian courts will endorse a common fund approach. If they do, funders will be able to obtain court approval at the commencement of a proceeding to recover their funding premium from all group members, not only from those who have signed a funding agreement. Advocates of this approach argue that it is permitted by the broad power given to the court by Section 33ZF(1) of the Federal Court Act to 'make any order the Court thinks appropriate or necessary to ensure that justice is done'. If the common fund approach is endorsed, funder reliance on closed classes will diminish and funders will be inclined to bring more 'open' class actions. The need for the extensive and time consuming book-building that funders now do to identify class members and to get signed contracts will also diminish, which in turn may make it possible for claims to be filed more expeditiously and with less expense for funders. Such a shift

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fund application at the beginning of a class action that allows the funder to receive a percentage of any settlement or award of damages.

36 *P. Dawson Nominees Pty Ltd v. Multiplex Limited* [2007] FCA 1061 (Finkelstein J) and *Multiplex Funds Management Limited Pty Ltd v. P. Dawson Nominees Pty Ltd* [2007] FCAFC 2000.

37 The relevant section states that where the threshold requirements are met by a group of persons, 'a proceeding may be commenced by one or more of those persons as representing some or all of them'.

to a common fund approach would further solidify the role of commercial funders as Australia's primary class action enabler.

Israel

Israel has had class actions for more than 20 years. The Israeli legislature has incorporated class action procedures into substantive laws in various sectors such as consumer protection, banking, insurance, securities, equal pay for equal work and equal rights for people with disabilities. Although not identical, these procedures were modeled on Rule 23 of the American Federal Rules of Civil Procedure, yet each was limited to a specific cause of action that was defined by the relevant statute. For example, the case studied in this part, *Shemesh v. Reichart* was initiated in 1995, based on a class action procedure enacted into the Israeli Securities Law.

In 2006, the Knesset (the Israeli legislature) enacted a new Class Action Law (hereinafter the CAL or the Law) which superseded all previous specific statutory arrangements. The new law maintained the substance-specific framework of the preceding statutes. Nevertheless, those causes of action were prescribed in a much broader manner, rendering certification easier, especially in consumer protection (including banking and insurance), in labor and anti-discrimination, and in restitution lawsuits filed against unlawful payments collected by state and public authorities. In addition, the new law prescribed various procedures for managing class actions which were not specified in detail by any prior legislation. These included certification of settlement and withdrawal from the class action, possible alternatives to individual remedies, attorney and representative plaintiff remuneration, and processing of multiple class action filings over similar issues and questions of law and fact.

In the ten years since its enactment, the CAL has generated a significant amount of litigation, from 26 class actions filed in 2006, to 820 filings in 2012.[38] Courts have been addressing numerous questions of interpretation of the new law, and have experimented with novel issues they had not previously encountered. Much has been written on those issues, focusing on the legal and normative implications of the act and proposing how it should be applied.

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38 All empirical data mentioned in this subsection are based on Klement et al., 2014, available (in Hebrew) at http://elyon1.court.gov.il/heb/Research%20Division/doc/25122014.pdf; Klement &Weinshall Margel, 2016.

The CAL provides specific arrangements that facilitate class actions through three types of enablers: representative plaintiffs, class attorneys and public funders.

Representative Plaintiffs: The law prescribes three categories of representative plaintiffs: (1) individual class members; (2) non-profit organizations; and (3) specifically designated public regulators. Nevertheless, in the first six years since its enactment, nearly all of the representative plaintiffs—99.3 percent—were individual class members. Very few class actions were filed by non-profit organizations and none were filed by public regulators.

When the class representative is a class member, he or she is required to show that his or her cause of action is one of the causes specified in the law. If loss is a necessary element of this cause of action, then the class representative must show that he or she suffered some loss. He or she also has to convince the court that he or she will represent class members adequately and in good faith.

However, even if the representative plaintiff does not satisfy one or more of these requirements, the court may nevertheless certify the class action and substitute the representative. The court will do so if it finds that other certification requirements are satisfied, namely that:

(1) there are common issues of fact or law pertaining to the class;
(2) there is a reasonable likelihood that these issues will be decided in favor of the class; and
(3) litigating the case as a class action will be efficient and fair.

This undermines the significance of certification requirements that pertain to the class representative. Indeed, in all motions to certify that were denied between 2006 and 2012, the court never based its decision to deny on requirements that pertain to the representative plaintiff only. This is one indication that the role of plaintiffs as enablers is often not significant.

Representative plaintiffs may be ordered to reimburse defendants for their litigation costs if class certification is denied or if the case is eventually lost. However, as in other civil cases, Israeli courts have wide discretion whether to award costs, and if they do, in what amount. The costs awarded in class actions therefore cover only part of the actual litigation costs borne by defendants (the median is NIS15,000 and average is NIS40,000). On the other hand, representative plaintiffs are rewarded if they win the class action or if it is settled. Incentive awards for representative plaintiffs in Israel are substantial, amounting to between one-fifth to one-third of the fee awarded to the class attorney.

Class Attorneys: The CAL delineates the duties of the class attorney toward the class, before and after certification. Like the representative plaintiff, the class attorney may be substituted by the court if other certification requirements are satisfied, but courts have almost never used this power. Class attorneys are paid a contingent fee, which is often set as a percentage of the common fund created in judgment or in settlement. The law lists a number of considerations the court must take into account when setting the attorney fee, including the benefit to the class, the risk and difficulty in litigating the class action, its public significance, the way the class action was conducted and the difference between the remedies sought and those actually awarded. In practice, class attorneys are awarded between 15 percent and 30 percent of the total remedy, depending on its amount.

It is commonly agreed among judges, practitioners and scholars that most class actions are attorney driven. Since the representative plaintiff's remedy is usually very low (median equal to NIS250), they are seldom the initiators of class actions. The facilitative goal of class attorneys has also been recognized by the Supreme Court, although the justices were divided on the question whether class action attorneys may initiate class actions by identifying causes of action and then approaching potential representative plaintiffs.[39] Moreover, courts expect class attorneys to take responsibility for the important litigation and settlement decisions, and some have even expressed their preference for attorneys over class representatives when the two disagree.

Public Funding: The CAL has established a designated public fund, whose purpose is to help representative plaintiffs in funding class certification motions and class actions, which it deems socially and publicly important. However, since the fund's budget is small (NIS1 million annually), its capability to facilitate class actions is limited, at best.

The designated fund cannot provide funding for securities class actions. Those class actions may be funded only by the Israeli Securities Authority (ISA), which has also designated a small share of its budget for this purpose. Although its designated funds are not substantial, the ISA has succeeded in increasing the number of securities class action filings since the enactment of the CAL. This facilitative effect can be attributed to the probative value of ISA's decision to fund a class action. Such a decision may indicate to the court that the ISA believes that the case is sufficiently strong and that it has significant social value.

[39] CA 8037/06 *Barzilay v. Prinir* (decided 4 September 2014).

To conclude, Israel has experienced an increasing number of class action filings in the past ten years. This trend is mainly attributed to the intense involvement of entrepreneurial attorneys in this field. Although the Israeli class action law recognizes alternative facilitators—class representatives and public funders—their significance as class action enablers does not seem to have been significant.

CONCLUSION

Class actions rely on entrepreneurial incentives for private actors to pursue public goals. Such incentives are created by institutional economic mechanisms, which result in different enablers dominating aggregate litigation. This Part presents case studies from diverse regimes and demonstrates the operation of class representatives, attorneys and funders within each of those regimes.

Two questions remain open for further research. The first is the question of agency. Since private and public incentives do not overlap, agency problems arise. Private enablers pursuing private economic goals might misuse the class action procedure for their own benefit, at the expense of represented class members. Which of the class action enablers is more prone to such problems, whose problems can be more effectively addressed, and how competition, monitoring and collaboration among different enablers affect their performance are all questions that should be examined more closely.

The second question is that of control. With the multiplicity of class action enablers comes a competition among them for control of the process. This creates potential conflicts which courts must address. For example, in exchange for assuming the considerable financial risk of complex litigation, funders want some control over how that litigation is conducted and managed. However, funder control of litigation can quickly run up against longstanding views about independence of counsel. This issue of funder control has arisen in both Canada and Australia, with markedly different results. How the debate about control will unfold in each jurisdiction is a matter of great importance, for practitioners, judges and scholars.

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