

Federal Class Actions, Contingency Fees, and the Rules Governing Litigation Costs

VINCE MORABITO*

I INTRODUCTION

The question of costs is the single most important issue that this Commission has considered in designing an expanded class action procedure ... the matter of costs will not merely affect the efficacy of class actions, but in fact will determine whether this procedure will be utilized at all.¹

There appears to be widespread acceptance of the notion that access to the courts and, therefore, to justice is a fundamental right of every citizen.² As was recently indicated by the Access to Justice Advisory Committee ('the AJAC'), 'all Australians, regardless of means, should have access to high quality legal services or effective dispute resolution mechanisms necessary to protect their rights and interests'.³

In recent years there has been heightened awareness of the sad reality that, for most members of the public, access to the courts is beyond their reach as a result of the high cost of litigation.⁴ One of the measures implemented by the

* BEc, LLB (Hons), LLM (Monash); Barrister and Solicitor of the Supreme Court of Victoria; Lecturer in Law, Deakin University. I wish to thank Professor Michael, Tilbury of the NSW Law Reform Commission, Mr Judd Epstein of Monash University, Mr Greg Reinhardt of the University of Melbourne and Professor John Vargo of Deakin University for their comments and suggestions on an earlier draft of this article. I also wish to thank Mr Michael McGowan, Vice-Chair of Ontario's Class Proceedings Committee, who provided me with many of the Canadian materials referred to in this article.

¹ Ontario Law Reform Commission, *Report on Class Actions* (1982) 647. ('Ontario Report').

² See A M Gleeson, 'Access to Justice' (1992) 66 ALJ 270; Law Institute of Victoria, *Funding Litigation — the Contingency Fee Option* (1989) para 3.3.1 ('Funding Litigation'); G T McLaughlin, 'The Recovery of Attorney's Fees: A New Method of Financing Legal Services' (1972) 40 *Fordham Law Review* 762, 786; Senate Standing Committee on Legal and Constitutional Affairs, *Cost of Legal Services and Litigation — Discussion Paper No 3: Contingency Fees* (1991) para 2.3 ('Senate Discussion Paper'); R C A White, 'Contingent Fees: A Supplement to Legal Aid?' (1978) 41 *Modern Law Review* 286, 294; B J Birrell, 'Contingent Fees — A Viable Alternative?' (1981) 55 ALJ 333.

³ Access to Justice Advisory Committee, *Access to Justice — An Action Plan* (1994) para 1.9 ('Action Plan'). See also Attorney-General's Department, *The Justice Statement* (May 1995) 2 ('Justice Statement').

⁴ See D Worthington and J Baker, *The Costs of Civil Litigation* (1993) 14; Action Plan, op cit (fn 3) para 1.3; Senate Discussion Paper, op cit (fn 2) para 2.4; Law Reform Commission of Victoria, *Issues Paper: the Cost of Litigation* (1990) 3 ('Cost of Litigation'); A Mason, 'The State of the Australian Judicature' (1989) 63 LJ 974, 976; Australian Law Reform Commission, *Who Should Pay? A Review of the Litigation Costs Rules* (Issues Paper 13, October 1994) para 4.3 ('Costs Rules'); R Smith, 'The Contingency Fee Option' (1989) 63 LJ 959, 961; White, op cit (fn 2) 286; G B Butler and B D Miller, 'Fiddling While Rome Burns: A Response to Dr Hensler' (1992) 75 *Judicature* 251; Birrell, op cit (fn 2) 338; McLaughlin, op cit (fn 2) 786; B M DeBelle, 'Class Actions for Australia? Do They Already Exist?' (1980) 54 ALJ 508, 515-16; K M Clermont and J D Curran, 'Improving on the Contingent Fee' (1978) 63 *Cornell Law Review* 529, 567; Senate Standing Committee on Legal and Constitutional Affairs, *The Cost of Justice —*

Commonwealth government, in order to facilitate the community's access to justice, was the enactment of Part IVA of the *Federal Court of Australia Act 1976* (Cth) ('the Act') which, in March 1992,⁵ introduced the most extensive framework regulating class actions ever seen in Australia. Mr Michael Duffy, the then Commonwealth Attorney-General, revealed in Parliament, during the Second Reading of the Act, that one of the purposes of the class action procedure introduced under the Act was,

to provide a real remedy where, although many people are affected and the total amount at issue is significant, each person's loss is small and not economically viable to recover in individual actions. It will thus give access to the courts to those in the community who have been effectively denied justice because of the high cost of taking action.⁶

Unfortunately, the Commonwealth government failed to recognise that the existing costs rules governing litigation, if applied unaltered to class actions, could constitute 'a disincentive to bringing grouped proceedings and might in fact create yet another barrier to access to legal remedies of the kind which the recommended procedure itself aims to overcome'.⁷ The most fundamental rule concerning costs is the 'costs indemnity rule' pursuant to which costs⁸ are generally awarded⁹ against the losing party. The costs awarded to the successful party, commonly referred to as 'party-party costs', usually represent two-thirds of the total costs actually incurred by him/her.¹⁰ Consequently, a

Foundations for Reform (1993) 4; Senate Standing Committee on Legal and Constitutional Affairs, *Costs of Legal Services and Litigation — Discussion Paper No 7: Legal Aid — 'For Richer and For Poorer'* (1992) para 1.7 ('Legal Aid Paper'); Law Reform Commission of Victoria, *Access to the Law: Restrictions on Legal Practice* (Discussion Paper No 23, 1991) para 2 ('Legal Practice Paper'); New South Wales Law Reform Commission, *Barratry, Maintenance and Champerty* (Discussion Paper 36, 1994) para 2.17 ('Barratry Paper').

⁵ See s 2(2) of the *Federal Court of Australia Amendment Act 1991* (Cth). The Act was largely based on the recommendations contained in Australian Law Reform Commission, *Grouped Proceedings in the Federal Court* (Report No 46, 1988) ('Grouped Proceedings'). For an outline of the fascinating background to the enactment of the Act see V Morabito, 'Class Actions — the Right to Opt Out Under Part IVA of the *Federal Court of Australia Act 1976* (Cth)' (1994) 19 *Melbourne University Law Review* 615, 617.

⁶ *Parliamentary Debates*, House of Representatives (Cth), 14 November 1991, 3174. See also Morabito, op cit (fn 5) 627–8 and the articles cited therein. The cogency of Mr Duffy's reasoning becomes evident when one considers that 'injuries to many persons in the same or similar positions ... are a characteristic and inevitable risk of a highly developed industrialised society'; Ontario Report, op cit (fn 1) 4.

⁷ Grouped Proceedings, op cit (fn 5) para 252.

⁸ 'There are many costs associated with litigation. These include the cost of legal advice and assistance, disbursements, court charges and transcript fees': Costs Rules, op cit (fn 4) para 4.2.

⁹ 'A court 'awards' costs when it orders a party to proceedings to pay the legal costs of the other party': id, para 2.2.

¹⁰ See Debelle, op cit (fn 4) 509; J Epstein, 'The Key to the Courthouse: the Introduction of Contingency Fees in Victoria' (1987) 61 LJ 1264, 1265; Action Plan, op cit (fn 3) para 5.60, fn 77; Grouped Proceedings, op cit (fn 5) para 254; Costs Rules, op cit (fn 4) para 4.31. It should be noted that in New South Wales a successful party is entitled to recover the reasonable costs and disbursements of all work that was reasonable to be carried out: s 208A *Legal Profession Act 1987* (NSW). The NSW approach is designed to 'close the gap that currently exists between party and party costs and the actual costs of litigation': Costs Rules, op cit (fn 4) para 6.31.

litigant faces the prospect, should he/she lose the case, of being liable for, not only his/her own legal costs,¹¹ but also a significant portion of the costs incurred by his/her adversary. This potential liability for thousands of dollars¹² has the practical effect of deterring many individuals, including those with meritorious claims, from taking legal action.

But this barrier to the initiation of the traditional one plaintiff v one defendant proceedings pales into insignificance when compared with the detrimental effect that the existing costs rules have upon pursuit of representative proceedings under the Act. Class proceedings tend to last longer and be more complex than individual suits.¹³ But more importantly, a number of procedural requirements or safeguards are prescribed under the Act, which are not found in non-representative suits, as they are designed to protect the interests of 'absent' class members. These safeguards include the requirement that notice be provided to group members of the 'commencement of the proceeding and the right of the group members to opt out'¹⁴ of the proceeding¹⁵ and the requirement that the court needs to give its approval before a class action can be settled or discontinued.¹⁶ These additional requirements increase substantially the costs incurred by the representative plaintiff¹⁷ and render a class suit a considerably more expensive form of litigation than individual proceedings.¹⁸

Potential representative plaintiffs whose claims are individually non-recoverable¹⁹ would be unlikely to commence class actions as the extent of

¹¹ They are commonly known as 'solicitor-client costs'.

¹² According to a study conducted by the Civil Justice Research Centre in 1993, the average solicitor's fee in New South Wales was in excess of \$20 000 in a Supreme Court action and over \$6000 in a case before the District Court: Worthington and Baker, *op cit* (fn 4) 14. In relation to Victoria, see Cost of Litigation, *op cit* (fn 4) 3.

¹³ 'The costs which arise when conducting litigation on behalf of more than one person may be higher for both the applicant and the respondent when compared with similar individual proceedings': Grouped Proceedings, *op cit* (fn 5) para 252. See also Debele, *op cit* (fn 4) 512; J S Emerson, 'Class Actions' (1989) 19 VUWLR 183, 206.

¹⁴ The Act implemented the opt out model pursuant to which 'the consent of a person to be a group member in a representative proceeding is not required': s 33E. Section 33J(2) allows 'a group member ... [to] opt out of the representative proceeding by written notice given under the Rules of Court'. See generally, Morabito, *op cit* (fn 5).

¹⁵ Section 33X(1)(a). The Federal Court may, however, dispense with notice 'where the relief sought in a proceeding does not include any claim for damages': s 33X(2). Rule 23 of the United States Federal Rules of Civil Procedure, which governs class litigation in American federal courts, requires courts, in class actions seeking damages, to 'direct to the members of the class the best notice practicable under the circumstances, including individual notice to all members who can be identified through reasonable effort': 23(c)(2).

¹⁶ Section 33V(1).

¹⁷ Section 43(1A) of the Act forbids the Federal Court from awarding costs against class members. Furthermore, class members are under no legal obligation to provide financial assistance to the representative plaintiff in relation to solicitor-client costs.

¹⁸ See A Homburger, 'State Class Actions and the Federal Rule' (1971) 71 *Columbia Law Review* 609, 649; H P Glenn, 'Class Actions in Ontario and Quebec' (1984) 62 *Canadian Bar Review* 247, 264-8; P M Iacono, 'Class Actions and Products Liability in Ontario: What Will Happen?' (1991) 3 *Canadian Insurance Law Review* 99, 103.

¹⁹ 'A claim is individually non-recoverable if it would not justify the expense to an individual of independent litigation but would justify the lesser expenditure required to obtain a share of a class judgment': Note, 'Developments in the Law — Class Actions' (1976) 89 *Harvard Law Review* 1318, 1356 ('Harvard Note').

their potential liability for costs would exceed the value of their own claim.²⁰ This state of affairs precludes the attainment of the 'access to justice' goal of class actions. In relation to those potential class representatives, whose claims are individually recoverable,²¹ individual proceedings constitute a more appealing option than grouped proceedings as they involve lower costs.²² Consequently, another major goal of class actions, commonly referred to as the 'judicial economy' goal,²³ becomes unreachable.

The conclusions above point clearly towards the fundamental need to shift the liability for all or some of the costs incurred by the class, from the representative plaintiffs to other persons. As the South Australian Law Reform Committee ('the SALRC') noted in 1977:

The present costs rules . . . present an insurmountable problem to the maintenance of a class action. . . . If the representative or class action is to be effective as a weapon in the hands of citizens whose rights have been infringed, a reformulation of the rules of law governing such actions is necessary.²⁴

Sadly, this was not the approach implemented under the Act. In fact, the Commonwealth government rejected the recommendations of the Australian Law Reform Commission ('the ALRC') that class representatives be allowed to enter into 'contingency fee' arrangements with the lawyers representing the class and that a public fund be established to provide financial assistance to the class representatives.

It is the aim of this article to evaluate possible ways of dealing with the cost barriers outlined above. The first option is to require 'contributions' from the class members. This option will be the subject of Part II. In Part III, the desirability of allowing the legal representatives, acting on behalf of the class, to be paid on a 'no win-no compensation' basis will be considered. Proposals to modify the costs indemnity rule, in relation to class action procedures, will

²⁰ 'Few representative plaintiffs would be foolish enough to agree to bear the high expenses of class or derivative litigation in the event of nonsuccess when their expected recovery from the lawsuit is much lower than their expected costs': J R Macey and G P Miller, 'The Plaintiffs' Attorney's Role in Class Action and Derivative Litigation: Economic Analysis and Recommendations for Reform' (1991) 58 *University of Chicago Law Review* 1, 86. See also Emerson, *op cit* (fn 13) 206.

²¹ 'A claim is individually recoverable if it warrants the costs of separate litigation; that is, if an action to recover the claim would be economically rational regardless of the availability of class action procedures': Harvard Note, *op cit* (fn 19) 1356.

²² 'The representative plaintiff's liability for the defendant's costs in a losing action, his inability to demand contribution by class members . . . and the widespread prohibition against contingent fees have together created a situation where a representative plaintiff is never better off in economic terms bringing his action in class rather than individual form': D N Dewees, J Robert, S Prichard, and M J Trebilcock, 'An Economic Analysis of Cost and Fee Rules for Class Actions' (1981) 10 *Journal of Legal Studies* 155, 157. See also Ontario Report, *op cit* (fn 1) 659; W A Bogart, 'Questioning Litigation's Role — Courts and Class Actions in Canada' (1987) 62 *Indiana Law Journal* 665, 695.

²³ 'Judicial economy' can be achieved by conducting a single determination of issues which are common to members of a group rather than allowing individuals with individually recoverable claims to initiate their own separate proceedings.

²⁴ Law Reform Committee of South Australia, *Report Relating to Class Actions* (Report No 36; 1977) 6 ('SALRC Report'). See also Ontario Report, *op cit* (fn 1) 689 ('the consensus as to the necessity for fundamental change is striking').

be analysed in Part IV. The possibility of shifting some of the burdens of class suits from the representative plaintiffs to the government and third parties will be explored in Part V.

II CONTRIBUTIONS FROM THE 'FREE RIDERS'— THE CLASS MEMBERS

Absent class members who are the beneficiaries of the efforts of the class representative and the class lawyer, get a 'free ride' in two respects. First, since absent class members are not parties to the action, they are not potentially liable for the party and party costs of the defendant should the class action fail. Secondly, absent class members are not obliged to contribute to the solicitor and client costs owed by the class representative to the lawyer for the class, unless they have entered into agreements to do so.²⁵

The comments above provide a substantially accurate description of the position of class members under the Act. In fact, s 43(1A) provides that 'in a representative proceeding . . . the court or judge may not award costs against a person on whose behalf the proceeding has been commenced'.²⁶ Section 33ZJ(2) does, however, provide that, in successful class suits seeking monetary relief:

If, on an application under this section, the Court is satisfied that the costs reasonably incurred in relation to the representative proceeding by the person making the application are likely to exceed the costs recoverable by the person from the respondent, the Court may order that an amount equal to the whole or a part of the excess be paid to that person out of the damages awarded.

In light of this privileged position of class members, a crucial question which automatically arises is whether it is both feasible and desirable to shift some of the burdens of class suits from the representative plaintiff to the class members. This issue will be canvassed in this Part in relation to both solicitor-client costs and party-party costs.

Solicitor-Client Costs

Since a class suit is brought on behalf of, and thus for the benefit of, class members the most obvious solution to the problem of funding grouped proceedings would be to distribute the costs of such proceedings among all class

²⁵ Ontario Report, op cit (fn 1) 657. See also N Williams, 'Consumer Class Actions in Canada — Some Proposals for Reform' (1975) 13 *Osgoode Hall Law Journal* 1, 15; Dewees et al, op cit (fn 22) 158–9; D Kell, 'The Liability of Represented Persons for Party-Party Costs in Representative Actions' (1994) 13 *Civil Justice Quarterly* 233, 237.

²⁶ Sections 33Q and 33R represent two exceptions to this principle. In fact, s 33Q(3) provides that 'where the Court appoints a person other than the representative party to be a sub-group representative party, that person, and not the representative party, is liable for costs associated' with the sub-group. Section 33R imposes liability for costs on individual group members in relation to the determination of issues that relate solely to the claims of those members.

members. This is clearly the view taken by Emerson, who argues that 'if classes with genuine claims wish to pursue the claims through class procedure, it would seem appropriate that the risk of financial investment in the action should fall on those parties who would receive the direct benefit of an award.'²⁷

Emerson's proposal suffers from a number of fundamental problems, of a practical nature, which render it an unreliable method of financing the initiation and conduct of representative proceedings. One problem stems from the reluctance of most, if not all, absent class members to contribute to the expenses of the suit. This reluctance is attributable to two major factors. In the first place, class members will be able to enjoy the benefits flowing from a successful class suit whether or not they provide any financial assistance to the representative plaintiff.²⁸ Another reason for this reluctance is due to the remoteness of any potential benefit at the time the request for contributions is normally made, namely, at the early stages of the proceedings.²⁹

The first problem above could, of course, be rectified by empowering either the court or the representative plaintiff to compel contributions from the class members. This alternative would, however, be likely to lead to highly unsatisfactory consequences such as the exit of many class members from the class suit³⁰ as well as the need to implement 'expensive and laborious'³¹ measures to deal with those class members who refuse to pay their allotted share of the suit's expenses.³²

Even if a sufficient number of class members are willing to assist the representative plaintiff, other obstacles exist including the time and expense involved in negotiating for those contributions³³ as well as the great difficulty faced in calculating 'in advance the appropriate amount of each contribution'.³⁴

The only remaining option is to wait upon conclusion of the class suit in order to allocate solicitor-client costs among all class members. This is the

²⁷ Emerson, op cit (fn 13) 207. See also Homburger, op cit (fn 18) 649.

²⁸ 'Therefore, there will be no reason why a class member will make a financial contribution, other than out of a sense of outrage against the defendant or a concern that the burden of litigation be shared equitably. It is unlikely that a class plaintiff would initiate a class action and incur onerous financial risk, relying solely on the existence of such noble sentiments': Ontario Report, op cit (fn 1) 657.

²⁹ See Morabito, op cit (fn 5) 628; Ontario Report, op cit (fn 1) 685; Note, 'Developments — Legal Ethics' (1974) 3 *Class Action Reports* 174, 177.

³⁰ See L S Mullenix, 'Class Resolution of the Mass-Tort Case: A Proposed Federal Procedure Act' (1986) 64 *Texas Law Review* 1039, 1070.

³¹ Ontario Report, op cit (fn 1) 711.

³² Dewees et al, op cit (fn 22) 159.

³³ 'Typically, transaction costs will make infeasible the negotiation and enforcement of voluntary agreements between the class representative and class members concerning the sharing of costs': ibid. In Ontario, s 17(7) of the *Class Proceedings Act* 1992 provides that the notice sent to class members advising them of, among other things, the commencement of the class suit and their right to opt out 'may include [with leave of the court] a solicitation of contributions from class members to assist in paying solicitor's fees and disbursements'.

³⁴ Ontario Report, op cit (fn 1) 711. It has also been suggested that 'such an arrangement might create intraclass disagreements about strategy and litigation by committee': S L Martin, 'Syndicated Lawsuits: Illegal Champerty or New Business Opportunity?' (1992) 30 *American Business Law Journal* 485, 494.

approach followed by s 33ZJ(2) of the Act which allows the court to exact 'indirect' contributions from class members, in successful class suits for damages. Provisions similar to s 33ZJ(2) have been proposed by the ALRC,³⁵ the Ontario Law Reform Commission ('the OLRC')³⁶ and the SALRC.³⁷ In Ontario, s 32(2) of the *Class Proceedings Act* 1992 provides that 'amounts owing under an enforceable agreement [respecting fees and disbursements between the solicitor and the representative plaintiff] are a first charge on any settlement funds or monetary award'. Section 33ZJ(2) is based on the American 'Common Fund' doctrine.³⁸ In *Boeing Co v Van Gemert*,³⁹ the US Supreme Court explained that it,

has recognized consistently that a litigant or a lawyer who recovers a common fund for the benefit of persons other than himself or his client is entitled to a reasonable attorney's fee from the fund as a whole. The common fund doctrine reflects the traditional practice in courts of equity, and it stands as a well-recognized exception to the general principle that requires every litigant to bear his own attorney's fees. The doctrine rests on the perception that persons who obtain the benefit of a lawsuit without contributing to court costs are unjustly enriched at the successful litigant's expense. Jurisdiction over the fund involved in the litigation allows a court to prevent this inequity by assessing attorney's fees against the entire fund, thus spreading fees proportionately among those benefited by the suit.⁴⁰

This doctrine is applied to both the claimed and unclaimed portions of the fund created by the class suit. While deducting costs from the class recovery is a desirable measure, its severe limitations as a means of reducing the disincentives to the initiation of class suits created by solicitor-client costs must not be overlooked. Section 33ZJ(2) provides no financial relief to class representatives when the grouped proceeding reaches an unsuccessful conclusion.⁴¹ Furthermore, the common fund doctrine does not deal with the problem of insufficient funds to initiate the proceedings nor with the deterrent effect created by the prospect of having to pay both solicitor-client costs and party-party costs in the case of a win by the respondent. The other obvious

³⁵ Grouped Proceedings, op cit (fn 5) para 289.

³⁶ Ontario Report, op cit (fn 1) 714.

³⁷ SALRC Report, op cit (fn 24) 13.

³⁸ See C Silver, 'A Restitutionary Theory of Attorneys' Fees in Class Actions' (1991) 76 *Cornell Law Review* 656; A R Golbey, 'Attorney's Fees, Unclaimed Funds, and Class Actions: Application of the Common Fund Doctrine' (1979) 48 *Fordham Law Review* 370; J F Vargo, 'The American Rule on Attorney Fee Allocation: The Injured Person's Access to Justice' (1993) 42 *American University Law Review* 1567, 1578-81; J S Hoak, 'Attorney Fees: Exceptions to the American Rule' (1976) 25 *Duke Law Review* 717, 729-33; J P Dawson, 'Lawyers and Involuntary Clients: Attorney Fees from Funds' (1974) 87 *Harvard Law Review* 1597.

³⁹ 444 US 472, 478 (1980).

⁴⁰ A second rationale for this doctrine 'rests on public policy grounds: an attorney prosecuting private claims for violations of the antitrust, securities or consumer protection laws is viewed by the courts as a "vindicator of . . . public policy". Generous fees encourage vigilant private policing of violators': A Hammond, 'Stringent New Standards for Awards of Attorney's Fees' (1977) 32 *Business Lawyer* 523, 524. See also Silver, op cit (fn 38) 658.

⁴¹ This is, of course, the time when the representative plaintiff's need for financial assistance reaches overwhelming levels as he/she is liable for all of the class suit's expenses as well as a substantial portion of the respondent's costs.

limitation of s 33ZJ(2) is that 'if the class action seeks exclusively non-monetary relief, such as an injunction, there will be no monetary recovery from which fees and disbursements can be deducted'.⁴² In relation to this last problem, the 'substantial benefit' doctrine developed by American courts is of considerable interest.

As Vargo indicated:

The substantial benefit rule is closely related to the common fund doctrine. Both doctrines are based on the principle that non-parties benefiting from litigation should share in the legal expenses of the party bringing the action; this principle avoids unjustly enriching the absent beneficiaries. Unlike the common fund doctrine, however, the substantial benefit doctrine usually applies to nonpecuniary benefits.⁴³

Well-known illustrations of this doctrine can be found in two decisions of the US Supreme Court. In *Mills v Electric Auto-Lite Co*,⁴⁴ an injunction was obtained against a corporate merger approved by the shareholders on the basis of misleading proxy statements. The Supreme Court justified its decision to award costs against the defendant corporation on the ground that 'jurisdiction over the corporation as nominal defendant made it possible to assess fees against all of the shareholders through an award against the corporation'.⁴⁵ In *Hall v Cole*,⁴⁶ a case concerning the unfair expulsion by a union of one of its members, the Supreme Court awarded costs against the union by reasoning that 'reimbursement of respondent's attorneys' fees out of the union treasury simply shifts the costs of litigation to 'the class that has benefited from them and that would have had to pay them had it brought the suit'.⁴⁷

Contrary to the Supreme Court's comments above, *Mills* and *Hall* clearly indicate that while, in theory, the doctrine is based on the need for the 'non-party' beneficiaries of the litigation to make a contribution to the costs of the proceedings, in practice, the effect of the doctrine is to implement a 'one-way'⁴⁸ version of the costs indemnity rule by shifting the costs of the proceedings from the successful plaintiff to the unsuccessful defendant.⁴⁹ It is, in fact, difficult to see how the allocation of costs to separate legal entities such as companies⁵⁰ and unions can be said to be equivalent to the exaction of con-

⁴² Ontario Report, *op cit* (fn 1) 714.

⁴³ Vargo, *op cit* (fn 38) 1581.

⁴⁴ 396 US 375 (1970).

⁴⁵ *Id* 395.

⁴⁶ 412 US 1 (1973).

⁴⁷ *Id* 9.

⁴⁸ A 'one-way' costs rule is a rule pursuant to which costs are awarded in favour 'of only one party. Thus, if the plaintiff were the chosen beneficiary, a successful plaintiff would recover attorney's fees while a successful defendant would not': Vargo, *op cit* (fn 38) 1590.

⁴⁹ 'Both cases [*Mills* and *Hall*] resulted in fee-shifting to the defendants. . . . The common fund cases differ because fees are assessed against non-party beneficiaries, rather than against the defendant': Golbey, *op cit* (fn 38) 377.

⁵⁰ A duly incorporated company has 'a new, separate legal personality, with most of the legal characteristics of a natural person . . . [this] new legal person is an entity quite separate both from those who manage it (the directors) and from those who own it (the shareholders)': H L French, *Guide to Company Law* (2nd ed, 1987) 7.

tributions directly from the shareholders and union members themselves. For the reasons contained in Part IV below, a one-way costs rule is unacceptable. Nevertheless, the 'substantial benefit' doctrine is instructive to the extent that it recognises both the practical difficulties entailed in seeking contributions from the absent beneficiaries⁵¹ as well as the desirability of removing some of the cost disincentives which deter the commencement of legal proceedings that seek to secure non-monetary benefits for 'classes' of individuals.⁵²

Party-Party Costs

As noted earlier, s 43(1A) makes it clear that party-party costs are to be borne only by the representative plaintiff and not the class members.⁵³ This provision was enacted in response to the principle enunciated by the Full Court of the Supreme Court of Victoria⁵⁴ in *Burns Philp & Co Ltd v Bhagat* that the court had the power to make an award of costs 'against those who are represented by the plaintiff in a proceeding brought under ss 34 and 35 of the [Supreme Court] Act'.⁵⁵ The enactment of s 43(1A) can, perhaps, be regarded as an over-reaction to the Supreme Court's ruling. The Victorian provisions in question, ss 34 and 35 of the *Supreme Court Act* 1986, are diametrically opposed to the regime established pursuant to the Act, as they require an opt-in approach, pursuant to which the represented parties must give their consent in writing to the commencement of the class suit in order to be bound by the judgment handed down at the conclusion of the class suit. The Court itself made it quite clear that had it accepted the argument that there exists a general rule that a court could award costs only against a party on the record, 'the requirements of a representative proceeding under ss 34 and 35 makes persons represented so closely resemble parties named on the record as to bring them within an exception'⁵⁶ to this general rule. It must be said, however, that s 43(1A) ended the great uncertainty that surrounded this issue ever

⁵¹ 'Because the benefit is non-pecuniary, it has been necessary to rely on the interposition of an entity to bear the costs burden directly on behalf of the actual beneficiaries among whom, in theory, it should be allocated': Ontario Report, op cit (fn 1) 669. See also Vargo, op cit (fn 38) 1582.

⁵² As will be shown in Part V below, these two considerations were largely responsible for the author's recommendation that a public fund should be established to provide financial assistance to representative plaintiffs.

⁵³ In Ontario, s 31(2) of the *Class Proceedings Act* 1992 provides that 'class members, other than the representative party, are not liable for costs except with respect to the determination of their own individual claims.'

⁵⁴ See D M Ryan, 'The Development of Representative Proceedings in the Federal Court' (1993) 11 *Australian Bar Review* 131, 143.

⁵⁵ [1993] 1 VR 203, 223.

⁵⁶ Ibid. See also M Tilbury, 'The Possibilities for Class Actions in Australian Law', paper delivered at the 1993 Australian Legal Convention in Hobart, 2. The Supreme Court also added that 'it can safely be said that actions brought under [ss 34 and 35]... may be very remote from any popular notion of a class action': [1993] 1 VR 203, 224.

since the Federal Court of Australia Amendment Bill 1991 was introduced in Parliament in late 1991.⁵⁷

But the crucial question is, of course, whether it would be desirable for the Federal Court to have the power to award party-party costs against class members other than the class representative. Imposing this burden on all class members is not a realistic option. As was cogently argued by the ALRC:

It would be impracticable for them to be made to contribute to the respondent's costs, especially if they had received no personal notification. It would also be extremely difficult to apportion costs in an unsuccessful case because no assessment of the number of group members involved would have been made. The time and expense involved in identifying group members and extracting a contribution for costs would not be justified.⁵⁸

Furthermore, in relation to those members who have played a passive role, the imposition of liability for costs may be seen as an unduly harsh measure.⁵⁹ It may also induce a not insignificant number of class members to opt out.⁶⁰

Can it be argued, however, that the court should be allowed to attach liability for costs on identified members of the class suit such as those who were actively involved in the running of the litigation and/or provided financial assistance to the class representative? In *Knight v FP Special Assets Ltd*,⁶¹ the High Court held that the Supreme Court of Queensland had the power to order costs against the receivers and managers of two insolvent companies that were not parties to the litigation in question. In so holding, the majority justices revealed that it is,

appropriate to recognise a general category of case in which an order for costs should be made against a non-party. . . . That category of case consists of circumstances where the party to the litigation is an insolvent person or man of straw, where the non-party has played an active part in the conduct of the litigation and where the non-party . . . has an interest in the subject of the litigation. Where the circumstances of a case fall within that category, an order for costs should be made against the non-party if the interests of justice require that it be made.⁶²

The application of this principle to class suits would appear to be welcomed by a number of commentators who have drawn attention to the ability of class

⁵⁷ See *Parliamentary Debates*, House of Representatives (Cth), 26 November 1991, 3286, 3295; Ryan, op cit (fn 54) 138–41. This uncertainty over liability for costs could have, itself, created another disincentive to the commencement of grouped proceedings, at least until the Federal Court was offered an opportunity to express its views on the matter.

⁵⁸ Grouped Proceedings, op cit (fn 5) para 258.

⁵⁹ 'For my part, I have some difficulty with the idea that liability for costs might attach to group members taking no active part in class proceedings brought on their behalf': Ryan, op cit (fn 54) 141.

⁶⁰ Tilbury, op cit (fn 56) 2; G Reinhardt, 'Class Actions in Victoria: Quo Vadis?' (1993) 67 LJ 61, 61.

⁶¹ (1992) 107 ALR 585.

⁶² Id 595. See also ALRC, *Litigation Cost Rules* (Draft Recommendations Paper 1, June 1995) para 12.2 ('ALRC Draft Paper'): 'the courts have indicated that it may be appropriate to order a person who is not a party to pay costs where the person is the effective litigant standing behind an actual party or where there has been a contempt or abuse of the process of the courts'.

members to abuse their immunity from an adverse award of costs by simply selecting an impecunious, and thus judgment-proof, representative plaintiff.⁶³ It is submitted, however, that the extension of the *Knight* principle to class suits brought under the Act is unnecessary because, in addition to the general power concerning security for costs,⁶⁴ the Federal Court has, at its disposal, extensive powers to order that a proceeding no longer continue as a class action⁶⁵ and to replace those representative plaintiffs who, in the court's view, are 'not able adequately to represent the interests of the group members'.⁶⁶ In the US, the 'adequate representation' provision has been utilised by the courts to scrutinise, among other things, the ability of class representatives to finance the proceedings.⁶⁷

Kell has raised the possibility of allowing judges discretion to conclude 'that a person who contributed, say, ten per cent of the costs of the representative action which the defendant had to meet, ought now to be liable to pay ten per cent of the defendant's properly taxed costs'.⁶⁸ This option is, however, undesirable as it would discourage class members from accepting some of the financial burdens of the class suit, thereby drying up a possible source of financial assistance to the class representative.⁶⁹

The analysis in this Part has demonstrated that the only cost-sharing scheme that is feasible is one pursuant to which solicitor-client costs are deducted from the monetary compensation awarded in favour of the class, before such compensation is distributed among class members. To address the 'financial barriers' faced by representative parties⁷⁰ at the commencement of class suits, we must look elsewhere.

⁶³ Ryan, op cit (fn 54) 141-2; P Costello, *Parliamentary Debates*, House of Representatives (Cth), 26 November 1991, 3286; D Kell, 'The Liability of Represented Persons for Party-Party Costs in Representative Actions' (1994) 13 *Civil Justice Quarterly* 233, 237.

⁶⁴ Section 33ZG(c) makes it clear that nothing in Part IVA affects 'the operation of any law relating to . . . security for costs.'

⁶⁵ R B Baxt, 'Class Action Legislation — A Mirage for the Consumer?' (1992) 66 ALJ 223, 224. See ss 33L, 33M, 33N. The court could also rely on s 33ZF(1) which allows the court to 'make any order the Court thinks appropriate or necessary to ensure that justice is done in the proceeding.'

⁶⁶ Section 33T(1). A similar requirement is contained in s 5(1)(e)(i) of Ontario's *Class Proceedings Act* 1992.

⁶⁷ See Macey and Miller, op cit (fn 20) 84-91; K A Freeman, 'Conflicts of Interest in Class Action Representation Vis-à-Vis Class Representative and Class Counsel' (1986) 33 *Wayne Law Review* 141, 144-5; Mullenix, op cit (fn 30) 1084; L S Bush, 'My Brother's Keeper — Some Observations on Federal Rule 23 and Mass Tort Class Actions in the United States' (1986) 5 *Civil Justice Quarterly* 109, 116; G M Strickler, 'Protecting the Class: The Search for the Adequate Representative in Class Action Litigation' (1984) 34 *DePaul Law Review* 73.

⁶⁸ Kell, op cit (fn 63) 239.

⁶⁹ Kell, himself, does not appear to find this measure highly desirable as he concludes 'that all that can be said, for now, is that it is likely to be a matter of degree. However, it is to be hoped that orders for represented persons to pay party-party costs will be exceptional': *ibid*.

⁷⁰ 'The financial barriers to representative proceedings . . . [include] the high cost of retaining a lawyer, the potential expense of disbursements and the risk of an adverse costs award': The Law Society of Upper Canada, *Class Proceedings: Guidelines for Practitioners* (1993) 5. These 'barriers' are left untouched by s 33ZJ(2).

III CONTINGENCY FEES

As was indicated by the Senate Standing Committee, 'the defining characteristic of a contingency fee is that the client pays the lawyer only if the lawyer obtains the result sought. If the client loses, the lawyer is not paid or reimbursed for his or her work'.⁷¹ There are many forms which the contingency fee may take. Three major types of contingency fees can, however, be identified. The first type, called a speculative fee,⁷² involves the payment of the solicitor's 'normal' fee in the event of a successful outcome of the case. Another kind of contingency fee is the 'uplift fee' which 'is the same as a speculative fee, except that an uplift or loading (either a fixed sum, or percentage or multiple of the fee) is paid on top of (what would otherwise have been) the fee to cover the risk of loss'.⁷³ Probably the most widely known type of contingency fee is the percentage fee pursuant to which the lawyer receives a fixed or 'sliding' percentage⁷⁴ of the compensation awarded to the client.

⁷¹ Senate Standing Committee on Legal and Constitutional Affairs, *Cost of Legal Services and Litigation — Discussion Paper No 3: Contingency Fees* (1991) para 2.3 ('Senate Discussion Paper'), 3. See also F B MacKinnon, *Contingent Fees for Legal Services* (1964) 4; J Epstein, 'The Key to the Courthouse: the Introduction of Contingency Fees in Victoria' (1987) 61 LJ 1264, 1264; *City of Burlington v Dague* 112 S Ct 2638, 2640 (1992); Law Institute of Victoria, *Funding Litigation — the Contingency Fee Option* (1989) 5 ('Funding Litigation'); Great Britain, *The Royal Commission on Legal Services* (1979) 176 ('UK Commission on Legal Services'); Law Reform Commission of Victoria, *Access to the Law: Restrictions on Legal Practice* (Discussion Paper No 23, 1991) 22 ('Legal Practice Paper'); Trade Practices Commission, *Study of the Professions — Legal* (Draft Report, 1993) 226 ('TPC Draft Report'); Trade Practices Commission, *Study of the Professions — Legal* (Final Report, 1994) 141 ('TPC Final Report'); B J Birrell, 'Contingent Fees — A Viable Alternative' (1981) 55 ALJ 333; Access to Justice Advisory Committee, *Access to Justice — An Action Plan* (1994) para 6.2 ('Action Plan').

⁷² Senate Discussion Paper, op cit (fn 71) 4; Funding Litigation, op cit (fn 71) 6; TPC Draft Report, op cit (fn 71) 227; TPC Final Report, op cit (fn 71) 142; Action Plan, op cit (fn 71) para 6.4. The Commonwealth government has recently indicated that it 'will provide funding of \$10.5 million over three years to establish a national disbursements assistance fund. The fund will meet up-front costs of litigation, where the lawyers in the case are acting on a contingency or no fee (pro bono) basis': Attorney-General's Department, *The Justice Statement* (May 1995) 106 ('Justice Statement').

⁷³ TPC Draft Report, op cit (fn 71) 227.

⁷⁴ 'The fee may be a flat percentage of any recovery; a series of increasing or decreasing percentages depending upon the size of the recovery; a series of increasing percentages depending upon at which stage of negotiation or litigation recovery is secured; or perhaps a percentage of the recovery above a stated minimum recovery': A D Youngwood, 'The Contingent Fee — A Reasonable Alternative' (1965) 28 *Modern Law Review* 330, 331. See also Epstein, op cit (fn 71) 1267; W B Williston, 'The Contingent Fee in Canada' (1967) 6 *Alberta Law Review* 184, 188.

Current Position

In most Australian states, uplift fee and percentage fee agreements are not enforceable.⁷⁵ These restrictions have their origins in the common law offences and torts of 'maintenance' and 'champerty'.⁷⁶ In 1966, the UK Law Commission defined maintenance as 'the giving of assistance or encouragement to one of the parties to an action by a person who has neither an interest in the action nor any motive recognised as justifying his interference'.⁷⁷ Champerty is 'an aggravated form of maintenance, in which the maintainer receives something of value in return for the assistance given'.⁷⁸

Lawyers in South Australia,⁷⁹ New South Wales⁸⁰ and England⁸¹ are permitted to enter into uplift fee arrangements. Percentage fee and uplift fee agreements are generally permitted in the US⁸² and in some Canadian provinces.⁸³

⁷⁵ Senate Discussion Paper, op cit (fn 71) 5; Funding Litigation op cit (fn 71) 5; Grouped Proceedings, op cit (fn 5) paras 273-4; TPC Final Report, op cit (fn 71) 142; Legal Practice Paper, op cit (fn 71) 22-4; Law Reform Commission of Victoria, *Access to the Law: Restrictions on Legal Practice* (Report No 47, 1992) 8-9 ('Legal Practice Report'); B M DeBelle, 'Class Actions for Australia? Do They Already Exist?' (1980) 54 ALJ 508, 512; R Smith, 'The Contingency Fee Option' (1989) 63 LIJ 959, 959.

⁷⁶ 'Although the criminal offences of champerty and maintenance have been abolished in several states, they continue to be actionable torts and contingency fee agreements remain unenforceable contracts in several States. The rules of professional conduct of several law societies and Bar associations also prohibit practitioners from entering into contingency fee agreements. However, the position is now changing rapidly': Action Plan, op cit (fn 71) para 6.9.

⁷⁷ UK Law Commission, *Proposals for Reform of the Law Relating to Maintenance and Champerty* (Law Com No 7, 1966) para 3. See also Y L Tan, 'Champertous Contracts and Assignments' (1990) 106 LQR 656.

⁷⁸ New South Wales Law Reform Commission, *Barratry, Maintenance and Champerty* (Discussion Paper 36, 1994) para 2.7 ('Barratry Paper'). See also D Reichel, 'The Law of Maintenance and Champerty and the Assignment of Choses in Action' (1983) 10 *Sydney Law Review* 166, 167; D C Cox, 'Lawsuit Syndication: An Investment Opportunity in Legal Grievances' (1990) 35 *Saint Louis University Law Journal* 153, 159. It is interesting to note that in the US, 'the subject of maintenance and champerty . . . is sparking some current interest . . . because a few plaintiffs who could not afford to pursue legal actions on their own have attempted to support their litigation by selling shares in their lawsuits. Their opponents have objected that such arrangements are illegally champertous': S L Martin, 'Syndicated Lawsuits: Illegal Champerty or New Business Opportunity?' (1992) 30 *American Business Law Journal* 485, 485-6.

⁷⁹ See ss 41-2 of the *Legal Practitioners Act* 1981 (SA).

⁸⁰ See ss 186-8 of the *Legal Profession Act* 1987 (NSW). 'The Queensland Government also is committed to the introduction of contingency fees': Justice Statement, op cit (fn 72) 49.

⁸¹ See s 58 of the *Courts and Legal Services Act* 1990. In May 1995, the Commonwealth government indicated that 'in the event that other State and Territory Governments do not move to permit contingency fees, the Commonwealth is prepared to introduce uplift contingency fees in federal matters': Justice Statement, op cit (fn 72) 50.

⁸² 'A Rand Institute for Civil Justice survey found that 87 percent of accident claimants who engaged a lawyer entered into a contingent-fee arrangement': T J Miceli, 'Do Contingent Fees Promote Excessive Litigation?' (1994) 23 *Journal of Legal Studies* 211, 211. See also B L Smith, 'Three Attorney Fee — Shifting Rules and Contingency Fees: Their Impact on Settlement Incentives' (1992) 90 *Michigan Law Review* 2154, 2162 ('The contingency fee dominates most tort litigation in the United States today').

⁸³ For details see TPC Draft Report, op cit (fn 71) 231; Senate Discussion Paper, op cit (fn 71) 7-8; Funding Litigation, op cit (fn 71) 8-9; Epstein, op cit (fn 71) 1266; P P Mercer, 'Group Actions in Civil Procedure in Canada' in *Contemporary Law — Canadian Reports to the 1990 International Congress of Comparative Law, Montreal* (1990)

Australian lawyers, with the possible exception of Victorian lawyers, are permitted to charge a speculative fee,⁸⁴ as long as they satisfy the following two requirements:

One is that he has considered the case and believes that his client has a reasonable cause of action or defence as the case may be. And the other is that he must not in any case bargain with his client for an interest in the subject matter of litigation.⁸⁵

The crucial question that will now be addressed is whether the ALRC's proposal for the introduction of uplift fees for class suits initiated under the Act should be followed.⁸⁶

Contingency Fees — Solving Existing Problems Or Creating New Ones?

While a number of benefits are said to flow from the introduction of contingency fees,⁸⁷ the benefit that is of greatest relevance for present purposes is that of increasing access to justice by removing or reducing some of the costs disincentives that currently deter the initiation of legal proceedings.⁸⁸ Contingency fees⁸⁹ can open the doors of our legal system to those individuals who are not able to enforce their legal rights because they do not possess sufficient resources to finance the legal measures, such as litigation, that enforcement of their rights entails.⁹⁰ This greater access to our courts, and our legal system

249, 269–70; Grouped Proceedings, op cit (fn 5) paras 276–7; Ontario Report, op cit (fn 1) 721–5; Legal Practice Paper, op cit (fn 71) 24–5.

⁸⁴ It has been argued by the Legal Fees Committee of the Law Institute of Victoria that 'in Victoria, s 65(b) of the *Supreme Court Act* may throw some doubt on the legality in this State of speculative actions': Funding Litigation, op cit (fn 71) 6. This view was not shared by the Victorian Law Reform Commission: Legal Practice Paper, op cit (fn 71) 23–4.

⁸⁵ *Clyne v New South Wales Bar Association* (1960) 104 CLR 186, 203.

⁸⁶ Grouped Proceedings, op cit (fn 5) paras 273–300. Similar recommendations were put forward by the SALRC and the OLRC: see, respectively, Law Reform Committee of South Australia, *Report Relating to Class Actions* (Report No 36; 1977) 8; and Ontario Report, op cit (fn 1) 726–39. In 1992, the OLRC's recommendations concerning contingency fees were largely implemented through the enactment of the *Class Proceedings Act* 1992 (Ontario): ss 32, 33. See also the *Law Society Amendment Act (Class Proceedings Funding)* 1992.

⁸⁷ Some of the arguments in favour of contingency fees are discussed in B L Smith, op cit (fn 82) 2163; R Smith, op cit (fn 75) 960; T Thomason, 'Are Attorneys Paid What They're Worth? Contingent Fees and the Settlement Process' (1991) 20 *Journal of Legal Studies* 187, 187–8; Williston, op cit (fn 74) 199–200; Youngwood, op cit (fn 74) 333; TPC Draft Report, op cit (fn 71) 235–42; Birrell, op cit (fn 71) 335–7; Senate Discussion Paper, op cit (fn 71) 13–20; P H Corboy, 'Contingency Fees: The Individual's Key to the Courthouse Door' (1976) 2 *Litigation* 27, 28–30; Funding Litigation, op cit (fn 71) 12; Epstein, op cit (fn 71) 1266–7; K M Clermont and J D Currian, 'Improving on the Contingent Fee' (1978) 63 *Cornell Law Review* 529, 570; UK Commission on Legal Services, op cit (fn 71) 176.

⁸⁸ "Access to Justice" is what is colloquially termed a "motherhood" issue: Funding Litigation, op cit (fn 71) 13.

⁸⁹ For the remainder of this article, the term 'contingency fee' is used to describe fees such as the 'uplift fee' and the 'percentage fee' pursuant to which, in the event of success, the lawyer receives more than his/her normal fee.

⁹⁰ See A Hammond, 'Stringent New Standards for Awards of Attorney's Fees' (1977) 32 *Business Lawyer* 523, 528; J F Vargo, 'The American Rule on Attorney Fee Allocation: The Injured Person's Access to Justice' (1993) 42 *American University Law Review* 1567, 1618–19; R Smith, op cit (fn 75) 960; R C A White, 'Contingent Fees: A Sup-

generally, is achieved by transferring some of the risk, and part of the cost, of litigation 'from the clients to their lawyers who are better able to assess the risks involved and to bear those risks by spreading them over a large number of law suits'.⁹¹

The effect of contingency fees on class actions must be considered in relation to both individually recoverable claims and individually non-recoverable claims. In relation to the former, shifting liability for the costs incurred in running the class suit to the class lawyer may offset the existing incentive for potential class representatives to initiate individual proceedings, instead of class suits, which is created by the substantially higher costs, compared with individual proceedings, of running a class suit.⁹² In relation to class actions seeking claims that are individually non-recoverable, 'allowing a fee agreement could provide access to the court for those who would otherwise be denied a remedy'⁹³ by relieving the class representative of the liability to pay the most significant set of costs, solicitor-client costs. These costs, by definition, exceed the value of the class representative's own claim.⁹⁴

A predictable response to the access to justice argument by the opponents of contingency fees has been to argue that contingency fees will lead to a 'litigation explosion', including the commencement of vexatious suits.⁹⁵ This argument has been persuasively rejected by a number of commentators who have pointed out that,

the risk of loss does not disappear; it simply shifts to the plaintiff's lawyer. Since contingency makes his fee depend on the outcome, the lawyer would shy away from any case with a probability of success so low that it makes the case a poor investment. . . . Indeed, a contingent fee may be more effective than a certain fee in deterring such suits . . . [because] under a contingent fee the primary screening function shifts to the lawyer, and the lawyer will probably do a more effective screening job.⁹⁶

plement to Legal Aid?' (1978) 41 *Modern Law Review* 286, 289; Senate Discussion Paper, op cit (fn 71) 13-16; Martin, op cit (fn 78) 490-1; Funding Litigation, op cit (fn 71) 13-16; Epstein, op cit (fn 71) 1264; Legal Practice Paper, op cit (fn 71) 27-8; Action Plan, op cit (fn 71) 184.

⁹¹ TPC Draft Report, op cit (fn 71) 233.

⁹² 'In the case of individually recoverable claims, no actions will be brought in class form on purely economic grounds under the present Anglo-Canadian [and Australian] cost rule governing class actions': D N Dewees, J Robert, S Prichard, and M J Trebilcock, 'An Economic Analysis of Cost and Fee Rules for Class Actions' (1981) 10 *Journal of Legal Studies* 155, 183.

⁹³ Grouped Proceedings, op cit (fn 5) para 283.

⁹⁴ See Harvard Note op cit (fn 19) and Dewees *et al*, op cit (fn 92) 183 ('in the case of individually non-recoverable . . . claims, in order to achieve a level of litigation that would occur if a single plaintiff held the entire class claim . . . it is necessary to combine both contingent fees and the opportunity for the class representative to avoid all other downside risks').

⁹⁵ See Funding Litigation, op cit (fn 71) 16-20; Lord Chancellor's Department, *Contingency Fees: A Green Paper* (1989), para 3.6; Comment, 'Are Contingent Fees Ethical Where the Client is Able to Pay a Retainer?' (1959) 20 *Ohio State Law Journal* 329, 339; UK Commission on Legal Services, op cit (fn 71) 176; MacKinnon, op cit (fn 71) 4-5.

⁹⁶ Clermont and Currihan, op cit (fn 87) 571-2. See also R Smith, op cit (fn 75) 960; Funding Litigation, op cit (fn 71) 21-3; Legal Practice Paper, op cit (fn 71) 28-30, 36; TPC Draft Report, op cit (fn 71) 242; B J Birrell, 'Contingent Fees — A Viable Alternative?' (1981) 55 *ALJ* 333, 337; Senate Discussion Paper, op cit (fn 71) 21; J S Emerson,

The argument above assumes an even more persuasive dimension when considered in the context of class suits which are more expensive⁹⁷ than traditional suits and which, as the experience overseas indicates, represent a very small percentage of all legal actions.⁹⁸

The most persuasive criticism of contingency fee agreements is the potential for conflict of interest which they create in relation to such matters as settlement of the client's claim. The contingent nature of the lawyer's remuneration creates a strong financial incentive for the lawyer to 'accept a small settlement in order to ensure some fees, rather than risk losing at trial and recovering nothing'.⁹⁹ This incentive to settle for sub-optimal¹⁰⁰ amounts would appear to exist in relation to both uplift¹⁰¹ fees and percentage fees.¹⁰²

'Class Actions' (1989) 19 VUWLR 183, 208; Epstein, op cit (fn 71) 1266; Action Plan, op cit (fn 71) 185.

⁹⁷ 'A class lawyer is unlikely to enter into a contingency fee agreement unless he or she believes there is a strong likelihood the lawsuit will be successful and the defendant will be able to pay': M McGowan, *A Class Representative's Guide to Class Actions* (Toronto, 1994) 12.

⁹⁸ In the US, 'federal class action filings reached their peak in 1976 when federal courts had 3584 class actions on file. . . . But even at that peak, class actions composed only 2.7% of all civil suits filed': M K Kane, 'Of Carrots and Sticks: Evaluating the Role of the Class Action Lawyer' (1987) 66 *Texas Law Review* 385, 386. See also B Garth, I H Nagel and S J Plager, 'The Institution of the Private Attorney General: Perspectives from an Empirical Study of Class Action Litigation' (1988) 61 *Southern California Law Review* 353, 370. In Quebec 'in the 12 years following the enactment of the Quebec class action legislation . . . there have been a total of 244 applications to certify class actions, resulting in 62 actions being certified': G D Watson, 'Ontario's New Class Action Legislation' (1992) 12 *Butterworths Journal of International Banking and Financial Law* 365. See also H P Glenn, 'The Dilemma of Class Action Reform' (1986) 6 *Oxford Journal of Legal Studies* 262, 267; W A Bogart, 'Questioning Litigation's Role — Courts and Class Actions in Canada' (1987) 62 *Indiana Law Journal* 665, 687–8.

⁹⁹ C P Lu, 'Procedural Solutions to the Attorney's Fee Problem in Complex Litigation' (1991) 26 *University of Richmond Law Review* 41, 62. See also, S R Lazos, 'Abuse in Plaintiff Class Action Settlements: The Need for a Guardian During Pretrial Settlement Negotiations' (1985) 84 *Michigan Law Review* 308, 314–15; G P Miller, 'Some Agency Problems in Settlement' (1987) 16 *Journal of Legal Studies* 189; M L Schwartz and D J B Mitchell, 'An Economic Analysis of the Contingent Fee in Personal Injury Litigation' (1970) 22 *Stanford Law Review* 1125; and Clermont and Currihan, op cit (fn 87) 536.

¹⁰⁰ The term 'sub-optimal settlement' is used to describe settlements which do not reflect the merits of the plaintiff's case. It must be noted, however, that sub-optimal settlements are common, even in the absence of contingency fees, as 'uncertainty, delay, and fear of payment of costs have placed tremendous pressures on the injured party to settle': Vargo, op cit (fn 90) 1610. See also J C Alexander, 'Do the Merits Matter? A Study of Settlements in Securities Class Actions' (1991) 43 *Stanford Law Review* 497; H Genn, *Hard Bargaining Out of Court Settlement in Personal Injury Actions* (London, 1987) 169.

¹⁰¹ It has been argued that uplift fees create 'a strong incentive for cheap settlements on the eve of the trial. By that point, the attorney typically has expended nearly all of the time that determines her compensation and has no logical reason to accept the risks of going to trial; a large recovery for the client will not substantially affect her own fee award': J C Coffee, 'The Regulation of Entrepreneurial Litigation: Balancing Fairness and Efficiency in the Large Class Action' (1987) 54 *University of Chicago Law Review* 877, 888 ('Coffee, Chicago'). See also Alexander, op cit (fn 100) 541.

¹⁰² 'Attorneys compensated on a percentage method have an incentive to settle early for an amount lower than what might be obtained by further efforts. The attorney who puts in relatively few hours to obtain an early settlement is likely to earn a much greater compensation per hour of effort than an attorney who expends greater efforts and litigates a

An obvious response to this argument is to say that a client would not accept settlement terms which are contrary to his/her own best interests. Unfortunately, the fear of losing,¹⁰³ 'the client information disadvantage and the inability to evaluate'¹⁰⁴ the validity of the settlement package recommended by the lawyer may result in the client's authorisation of inferior recoveries.

The losses incurred as a result of the conflicts of interest which exist between principals and agents are described by economic scholars as 'agency costs'.¹⁰⁵ Given the unreliability of 'monitoring' by the client as a means of reducing agency costs, reliance must be placed on other safeguards such as the legal regulatory system and the importance placed by lawyers on maintaining a good reputation.¹⁰⁶ It is difficult to see, however, how the prospect of disciplinary action or loss of reputation¹⁰⁷ can provide an effective means of eliminating agency costs in the context of settlements given that the lawyers in question are able to point to the 'objective' fact that they have achieved a victory on behalf of their clients.¹⁰⁸ Furthermore, as Macey and Miller have pointed out, the devices to reduce agency costs 'are themselves costly'.¹⁰⁹

Agency costs are exacerbated in class actions as a result of a number of factors. In the first place, for most class members,¹¹⁰ including some

case to the point where the plaintiff's recovery is maximized': J R Macey and G P Miller, 'The Plaintiffs' Attorney's Role in Class Action and Derivative Litigation: Economic Analysis and Recommendations for Reform' (1991) 58 *University of Chicago Law Review* 1, 25.

¹⁰³ 'The general effect of the plaintiff's risk aversion is to reduce the likelihood of suit, for going to trial involves uncertainty, which by definition the risk-averse plaintiff but not the risk-neutral plaintiff finds disadvantageous': S Shavell, 'Suit, Settlement, and Trial: A Theoretical Analysis under Alternative Methods for the Allocation of Legal Costs' (1982) 11 *Journal of Legal Studies* 55, 61.

¹⁰⁴ TPC Draft Report, op cit (fn 71) 240.

¹⁰⁵ 'The term "agency costs" refers to both the costs the principal must incur to keep an agent loyal and to the losses that occur as a result of agent disloyalty that are not worth preventing': J C Coffee, 'Understanding the Plaintiff's Attorney: The Implications of Economic Theory for Private Enforcement of Law through Class and Derivative Actions' (1986) 86 *Columbia Law Review* 669, 680 ('Coffee, Columbia'). See also M C Jensen and W H Meckling, 'Theory of the Firm: Managerial Behaviour, Agency Costs and Ownership Structure' (1976) 3 *J Fin Econ* 305; Macey and Miller, op cit (fn 102) 12-19; Coffee, Chicago, op cit (fn 101) 882-5.

¹⁰⁶ 'While all (or most) lawyers are sensitive to economic concerns, and some no doubt fit the image of self-interested income maximizers ... such a picture is a gross oversimplification. Certainly, lawyers may and frequently do temper economic interest with other competing values, including professional standards and a sense of responsibility to the client': H M Kritzer, W L F Felstiner, A Sarat and D M Trubek, 'The Impact of Fee Arrangement on Lawyer Effort' (1985) 19 *Law and Society Review* 251, 253. See also Macey and Miller, op cit (fn 102) 15-18; J K Smith and S Cox, 'The Pricing of Legal Services: A Contractual Solution to the Problem of Bilateral Opportunism' (1985) 14 *Journal of Legal Studies* 167, 169.

¹⁰⁷ 'Reputations are inexact, suffer from time lag effects, and are subject to being "cashed in" by firms willing to sacrifice their reputations in exchange for increased short-term profits': Macey and Miller, op cit (fn 102) 17.

¹⁰⁸ The issues in question are 'highly subjective and imprecise': id 46.

¹⁰⁹ Id 19.

¹¹⁰ 'Because the individual class member's settlement award tends to be small, no member is financially motivated to expend the time and effort required to supervise the attorney closely. Moreover, any increase in the settlement award derived from close supervision of the attorney must be shared with all other class members, making it unlikely that the

representative plaintiffs,¹¹¹ the cost of monitoring the class lawyer exceeds the value of his/her own claim. In relation to those class members who are willing to actively monitor the class lawyer, the limitations of client monitoring as a means of reducing agency costs are intensified in class actions as a consequence of their greater factual and legal complexity.¹¹² This greater complexity, and thus higher cost, of class actions enhances the lawyer's financial incentive to recommend 'cheap' settlements. Conversely, the class members have a strong financial incentive to litigate as, unlike individual litigants, class representatives and 'contingency fee' class lawyers, no liability for costs attaches to them should the class suit fail.¹¹³

The problem of agency costs in class actions has been addressed by the requirement that settlements be approved by the court presiding over the class suit. Judicial approval of class settlements is required in Ontario,¹¹⁴ in Quebec,¹¹⁵ in Australia's Federal Court¹¹⁶ and in US federal courts.¹¹⁷ A similar requirement was also recommended by the SALRC,¹¹⁸ the ALRC¹¹⁹ and the OLCRC.¹²⁰ The experience in the US indicates, however, that if judicial approval of class settlements is to provide an adequate safeguard against conflicts of interest between class lawyers and class members, judges must be prepared to abandon their traditional passive approach and pursue vigorously the role of guardians of the interests of the absent class members. In fact, in hearings concerning class settlements the representatives of the class, the representative plaintiff and the class lawyer, and the defendant are united in their desire to have their settlement agreement approved by the court.¹²¹

benefits of supervision will outweigh the costs': Lazos, *op cit* (fn 99) 319. See also Alexander, *op cit* (fn 100) 536.

¹¹¹ 'In the class action . . . the representative plaintiff's stake will typically be much smaller than that of the lawyer': K W Dam, 'Class Actions: Efficiency, Compensation, Deterrence, and Conflict of Interest' (1975) 4 *Journal of Legal Studies* 47, 58. See also Alexander, *op cit* (fn 100) 535.

¹¹² See *In re WICAT Securities Litigation* 671 F Supp 726 (1986), 741 ('Class litigation is a process that seems strange to many class members and participation in that process would seem to be fairly intimidating'); Kane, *op cit* (fn 98) 394 ('the complexity of the litigation . . . is difficult if not impossible to explain to the layperson'); Rhode, 'Class Conflicts in Class Actions' (1982) 34 *Stanford Law Review* 1183, 1203 ('As a practical matter once a class is certified, named plaintiffs generally are neither highly motivated nor well situated to monitor the congruence between counsel's conduct and class preferences').

¹¹³ For class members, 'a defendant's judgment may mean simply the defeat of an expectation, often of relatively small amount; for his lawyer it can mean the loss of years of costly effort by himself and his staff': *Saylor v Lindsay* 456 F 2d 896 (1972), 900-1 (1972).

¹¹⁴ *Class Proceedings Act* 1992, s 29(2).

¹¹⁵ *Code of Civil Procedure*, RSQ 1977, c C-25, arts 1016 and 1025, as enacted by SQ 1978, c 8, s 3.

¹¹⁶ Section 33V(1) of the Act: 'A representative proceeding may not be settled or discontinued without the approval of the Court'.

¹¹⁷ Rule 23(e).

¹¹⁸ SALRC Report, *op cit* (fn 24) 15 (s 8(1) of the Draft Bill for a *Class Action Act*).

¹¹⁹ 'The Court's approval should be required for the settlement by the principal applicant of a group member's proceeding': Grouped Proceedings, *op cit* (fn 5) para 218.

¹²⁰ Ontario Report, *op cit* (fn 1) 806.

¹²¹ 'Settlement hearings are typically pep rallies jointly orchestrated by plaintiffs' counsel and defence counsel. Because both parties desire that settlement be approved, they have every incentive to present it as entirely fair': Macey and Miller, *op cit* (fn 102) 46.

Consequently, these hearings lack the 'adversarial' feature of proceedings which common law judges are so accustomed to and dependent upon. One measure, which is normally used in most class action regimes to deal with this problem is to require the representative plaintiff to provide to class members notice of the proposed settlement before the settlement is considered by the court.¹²² The purpose of this requirement is, of course, to provide class members with an opportunity to object to any settlement which they feel is contrary to their interests.¹²³ But, in practice, class members do not provide courts with a reliable source of information with which to assess the validity of the settlement. In the US, it has been noted that,

more often than not . . . notice fails to elicit intervention of absentee class members for the same reason that class members fail to control their representatives: an active class member incurs significant expenses without receiving commensurate benefits.¹²⁴

In order to deal with these perceived deficiencies of judicial scrutiny of class settlements, a number of American commentators¹²⁵ have recommended, and some US federal courts¹²⁶ have appointed,

'special counsels' to represent the class in order to preserve the adversarial nature of the proceedings. The guardian can serve as 'devil's advocate' both to safeguard the interests of the absentee class and to provide more information to the court.¹²⁷

These special counsels or guardians can also assist courts in relation to the other major measure that is commonly employed to deal with agency costs in class action regimes which allow the use of contingency fees, namely, judicial determination or approval of the professional fees of the class lawyer.

Both the ALRC¹²⁸ and the OLRC¹²⁹ have recommended the use of uplift

¹²² See, for instance, r 23(e) (US); art 1025 of Quebec's *Code of Civil Procedure* 1977; and s 33X(4) of the Act ('Unless the Court is satisfied that it is just to do so, an application for approval of a settlement under section 33V must not be determined unless notice has been given to group members').

¹²³ 'Group members should also be given notice of a proposed settlement a reasonable time before the application to approve the settlement is heard so that their views on the settlement can be made known to the Court': Grouped Proceedings, op cit (fn 5) para 188.

¹²⁴ Lazos, op cit (fn 99) 324. See also Lu, op cit (fn 99) 61; G P Miller, 'Problems of Giving Notice in Class Actions' (1973) 58 FRD 313, 321-2.

¹²⁵ See Lazos, op cit (fn 99) 326-32; Macey and Miller, op cit (fn 102) 47-8; Kane, op cit (fn 98) 399-400; Harvard Note, op cit (fn 19); J D Cooper and T Kirkham, 'Class Action Conflicts' (1981) 7 *Litigation* 35, 60.

¹²⁶ 'In the Federal Judicial Center Study, 87.5% of the Judges (56 of 64) have never appointed a guardian, and only 9.4% sometimes appointed them': Lu, op cit (fn 99) 64.

¹²⁷ Id 62-3. A number of commentators have put forward far more 'radical' proposals such as the auctioning of the claims of the class to the highest bidder: see Macey and Miller, op cit (fn 102) 105-18; L Herzel and R H Hagan, 'Plaintiffs' Attorneys Fees in Derivative and Class Actions' (1981) 7 *Litigation* 25, 27; Coffee, Chicago, op cit (fn 101) 691-3; N L Stasko, 'Competitive Bidding in the Courthouse: In Re Oracle Securities Litigation' (1994) 59 *Brooklyn Law Review* 1667.

¹²⁸ Grouped Proceedings, op cit (fn 5) para 293.

¹²⁹ Ontario Report, op cit (fn 1) 750. The recommendations of the OLRC were largely accepted by the Ontario legislature: see *Class Proceedings Act* 1992, s 33.

fees to compensate class lawyers who were hired on a 'no win-no fee' basis. These recommendations were largely based on the American 'lodestar' method of calculating legal fees. This approach involves two major steps. The first step involves the calculation of the lodestar.¹³⁰ The lodestar is arrived at by multiplying the number of reasonable hours spent by the lawyer on the litigation by a reasonable hourly rate for the lawyer's services.¹³¹ The lodestar is then increased or decreased¹³² by a 'multiplier'.¹³³ This multiplier reflects the 'contingent nature or risk in the particular case involved and the quality of the attorney's work'.¹³⁴

The lodestar method was devised by the Third Circuit in 1973 in *Lindy Bros Builders v American Radiator and Standard Sanitary Corp.*¹³⁵ While this case involved a class action seeking monetary compensation, the lodestar approach has also been applied in other contexts such as fee-shifting cases and class suits seeking non-monetary relief.¹³⁶ The creation and widespread application of the lodestar method was attributable to a growing recognition of the potential unfairness created by the use of the percentage fee, as a result of the lack of any real connection between the amount of work put in by the lawyers

¹³⁰ In Ontario the lodestar is called the 'base fee': *Class Proceedings Act* 1992, s 33.

¹³¹ 'To arrive at this lodestar figure, the court must (1) identify the compensable hours based on time records submitted by counsel, and (2) establish a reasonable hourly rate of compensation based on such considerations as the nature of the activities performed, the seniority of the attorneys involved, and the prevailing billing rates': K R Feinberg and J S Gomperts, 'Attorneys' Fees in the Agent Orange Litigation: Modifying the Lodestar Analysis for Mass Tort Cases' (1986) 24 *Review of Law and Social Change* 613, 617.

¹³² For an example of a 'negative multiplier' see *In Re Fine Paper Antitrust Litigation* 751 F 2d 562 (1984).

¹³³ Multipliers are 'notoriously inconsistent, ranging anywhere from zero to four': M Lapointe, 'Attorney's Fees' (1991) 59 *Fordham Law Review* 843, 858. A practical example of the operation of the lodestar approach was provided by McGowan (op cit (fn 97) 12-13):

Suppose a class action involves a senior lawyer whose hourly rate is \$275 per hour and a young lawyer whose hourly rate is \$160 per hour . . . the senior lawyer spends 150 hours and the young lawyer spends 200 hours . . . [If these rates and hours are regarded as reasonable by the court presiding over the class action, then the lodestar] is \$73,250 calculated as follows:

$$\begin{array}{rcl} \$275 \times 150 & = & \$41,250 \\ \$160 \times 200 & = & \$32,000 \\ & & \underline{\$73,250} \end{array}$$

Suppose further that the lawsuit is successful and the court sets the multiplier as 2.25. The class lawyers' final fee would therefore be \$164,812.50 calculated as follows:

$$\$73,250 \times 2.25 = \$164,812.50$$

¹³⁴ Third Circuit Task Force, 'Court Awarded Attorney Fees' (1985) 108 FRD 237, 243. ('Task Force'). See also A Hammond, 'Stringent New Standards for Awards of Attorney's Fees' (1977) 32 *Business Lawyer* 523, 527-32; Stasko, op cit (fn 127) 1676-8; Feinberg and Gomperts, op cit (fn 131) 617-20, 627-31; Alexander, op cit (fn 100) 538. However, the Supreme Court has ruled that, at least in the context of fee-shifting cases, the application of a 'multiplier' is generally inappropriate: see *City of Burlington v Dague* 112 S Ct 2638 (1992), 2639-44; *Blum v Stenson* 465 US 886 (1984), 899-900; *Pennsylvania v Delaware Valley Citizens Council for Clean Air* 483 US 711 (1987), 719-21.

¹³⁵ 487 F 2d 161 (1973).

¹³⁶ Hammond, op cit (fn 134) 533; Task Force, op cit (fn 134) 243.

and their remuneration.¹³⁷ In light of this consideration, it is somewhat ironic and disappointing that, since the late 1980s, an increasing number of American courts have abandoned the lodestar method in favour of the percentage fee approach.¹³⁸

Substantial impetus for this return to the pre-1973 position was, undoubtedly, provided by a report issued in 1985 by a Task Force of the Third Circuit, the same court which created the lodestar approach. This report contained the recommendation that in common fund cases and fee-shifting cases that are likely to result in a settlement fund, 'both typically class suits',¹³⁹ the court should compensate lawyers on the basis of the percentage fee method.¹⁴⁰

A number of arguments have been put forward against the lodestar method by a number of American courts and commentators. One criticism is that it 'increases the workload of an already overtaxed judicial system'.¹⁴¹ In light of the very limited number of class actions which are normally filed,¹⁴² and given the substantially smaller size of Australian 'classes' compared with US classes,¹⁴³ this weakness of the lodestar method is unlikely to create major problems if implemented under the Act.¹⁴⁴

Another common criticism of the lodestar method is that, since the amount of the lawyer's compensation is partly dependent on the number of hours he/she has expended on the case, it provides the lawyer with a financial incentive to over service the client, that is, to work more hours than required.¹⁴⁵ Regardless of the cogency of this argument in relation to American lawyers, it is difficult to see how the lodestar method can provide an additional incentive for Australian lawyers to over service their clients, given that, in most cases, they are paid on a time basis *and* are assured of payment irrespective of the outcome of the case they are running on behalf of their clients.¹⁴⁶ It is, therefore, reasonable to conclude that the existing system of

¹³⁷ Hammond, op cit (fn 134) 524; Task Force, op cit (fn 134) 242; J P Dawson, 'Lawyers and Involuntary Clients in Public Interest Litigation' (1975) 88 *Harvard Law Review* 849, 876.

¹³⁸ Macey and Miller, op cit (fn 102) 23; Stasko, op cit (fn 127) 1680-2; Lu, op cit (fn 99) 47; Alexander, op cit (fn 100) 501.

¹³⁹ Kane, op cit (fn 98) 385.

¹⁴⁰ Task Force, op cit (fn 134) 255-6.

¹⁴¹ Id 246. See also Stasko, op cit (fn 127) 1685; Lu, op cit (fn 99) 47; Coffee, Chicago, op cit (fn 101) 889; *Report of the Federal Courts Study Committee* (1990) 104; C Silver, 'Unloading the Lodestar: Toward a New Fee Award Procedure' (1992) 70 *Texas Law Review* 865, 867-8; D B Dobbs, 'Awarding Attorney Fees Against Adversaries: Introducing the Problem' [1989] *Duke Law Journal* 435, 436.

¹⁴² See fn 98 *supra*.

¹⁴³ This is attributable to the enormous difference between the populations of both countries. It would therefore be unlikely to see Australian judges making comments such as the following: 'I have examined each of the hundreds of pages of time entries submitted in support of the 41 955 hours of attorney and paralegal time claimed in the petition': *In re Continental Illinois Securities Litigation* 750 F Supp 868 (1990), 878.

¹⁴⁴ As was highlighted by the ALRC, 'the number of grouped proceedings will be small enough for this requirement not to impose an undue burden on the Court's resources': *Grouped Proceedings*, op cit (fn 5) para 293.

¹⁴⁵ See T D Rowe, 'Study on Paths to a 'Better Way': Litigation, Alternatives, and Accommodation' (Background Paper issued on behalf of the American Law Institute) [1989] *Duke Law Journal* 824, 893; Lu, op cit (fn 99) 44; Alexander, op cit (fn 100) 540.

¹⁴⁶ See A M Gleeson, 'Access to Justice' (1992) 66 *ALJ* 270, 272-3.

hourly fee creates for lawyers a far greater incentive to over service than would the introduction of contingency fee arrangements based on the lodestar method.

Another argument against the lodestar method is that it is excessively subjective, thereby leading to confusion, lack of predictability and inconsistent results.¹⁴⁷ This criticism is usually accompanied by the observation that,

courts claiming to follow the lodestar method use many different formulas and choose a wide range of multipliers under those formulas. Coincidentally, however, all of these arcane arithmetical calculations just happen to yield fee awards of about 25 to 30 percent of the recovery most of the time. Such consistency suggests that fee awards are really the product of a sub rosa percentage of the recovery approach.¹⁴⁸

In relation to the criticism that the lodestar approach is insufficiently objective, it should not be unduly difficult to provide judges, lawyers and litigants alike, with some assistance through detailed guidelines in the Act. Furthermore, some discretion must *perforce* be conferred on the court to allow it to reach a just result on the particular facts before it.¹⁴⁹

There would also appear to be little danger of Australian judges manipulating the subjectivity of the lodestar method in order to implement percentage fees. In a legal system that has traditionally 'looked down' on contingency fees, it is highly unlikely that judges would authorise windfall profits for class lawyers.¹⁵⁰

In conclusion, it can be said that the criticisms of the lodestar method put forward by American commentators appear to be either inapplicable to Australian circumstances or too concerned with the 'goals' of simplicity, predictability and efficiency and insufficiently concerned with the fundamental 'goal' of achieving just results.¹⁵¹ As was noted by the AJAC, 'percentage fees may present opportunities for exploitation of clients and for windfall

¹⁴⁷ See Macey and Miller, *op cit* (fn 102) 50-6; Task Force, *op cit* (fn 134) 246-7; Feinberg and Gomperts, *op cit* (fn 131) 617, 620, 623-5; Lu, *op cit* (fn 99) 48.

¹⁴⁸ Alexander, *op cit* (fn 100) 541. See also Task Force, *op cit* (fn 134) 247; Stasko, *op cit* (fn 127) 1685; W J Lynk, 'The Courts and the Plaintiffs' Bar: Awarding the Attorney's Fee in Class Action Litigation' (1994) 23 *Journal of Legal Studies* 185; W A Schaible, 'Attorneys' Fees — Conflicts created by the Simultaneous Negotiation and Settlement of Damages and Statutorily Authorized Attorneys' Fees in Title VII Class Action — *Prandini v National Tea Co* 557 F 2d 1015 (3rd cir 1977)' (1978) 51 *Tempe Law Quarterly* 799; Lu, *op cit* (fn 99) 48; W J Lynk, 'The Courts and the Market: An Economic Analysis of Contingent Fees in Class-Action Litigation' (1990) 19 *Journal of Legal Studies* 247, 250, 257-60; Mowrey, 'Attorneys Fees in Securities Class Action and Derivative Suits' (1978) 3 *J Corp L* 267, 345-7.

¹⁴⁹ See Hammond, *op cit* (fn 134) 534; Grouped Proceedings, *op cit* (fn 5) para 293.

¹⁵⁰ In Australia, the potential problem is the opposite one of 'court-supervised fee awards ... [not compensating] adequately for the risk undertaken by counsel acting on a contingency basis': H P Glenn, 'Class Actions in Ontario and Quebec' (1984) 62 *Canadian Bar Review* 247, 262.

¹⁵¹ See, for instance, Task Force, *op cit* (fn 134) 270.

gains to practitioners, quite removed from a fair assessment of the value of the work actually performed'.¹⁵²

Coverage of Contingency Fee Agreements

An important practical issue is whether the contingency fee agreement entered into by the class lawyer and the class representative should protect the class representative, not only from solicitor-client costs, but also from party-party costs. While such an agreement would provide a solution to the disincentive created by the potential liability for the opponent's costs, it would have two highly undesirable consequences. It would exacerbate the conflict of interest problem and it would increase substantially the compensation that would need to be paid to the lawyer if the case succeeded.¹⁵³

A contingency fee arrangement would be of very limited value in class actions unless it covered both the fees of the barristers¹⁵⁴ and all other disbursements incurred by the class. However, the high costs that need to be incurred in order to comply with the procedural safeguards that are unique to class actions may prompt many lawyers to object to the inclusion of disbursements in the contingency fee contract.¹⁵⁵ The most onerous of these procedural safeguards is that of sending notices to the absent class members to advise them of such matters as the commencement of the class suit.¹⁵⁶ An admirable solution to the problems created by the high cost of complying with the 'notice regime' is provided by the provisions of Ontario's *Class Proceedings Act* 1992. It provides that the court 'may dispense with notice if, having regard to the factors set out in subsection (3), the court considers it appropriate to do so'.¹⁵⁷ The factors to be considered by the court are the cost of giving notice, the nature of the relief sought, the size of the individual claims

¹⁵² Access to Justice Advisory Committee, *Access to Justice — An Action Plan* (1994) para 6.45 ('Action Plan'). See also Grouped Proceedings, op cit (fn 5) para 296; Committee on Class Actions of the Section of Corporation, Banking and Business Law, 'Recommendation Regarding Consumer Class Actions for Monetary Relief' (1974) 29 *Business Lawyer* 957, 971; TPC Draft Report, op cit (fn 71) 238; J F Grady, 'Some Ethical Questions About Percentage Fees' (1976) 2 *Litigation* 20.

¹⁵³ B L Smith, 'Three Attorney Fee — Shifting Rules and Contingency Fees: Their Impact on Settlement Incentives' (1992) 90 *Michigan Law Review* 2154, 2166; Great Britain, *The Royal Commission on Legal Services* (1979) 177 ('UK Commission on Legal Services').

¹⁵⁴ 'If the substantial burden of counsel's fees continues to fall either on the client or on the solicitor, it will seriously undermine any advantage which might otherwise accrue': R Smith, 'The Contingency Fee Option' (1989) 63 *LIJ* 959, 961.

¹⁵⁵ 'Covering the costs of the disbursements for such a lawsuit in itself is a tremendous burden': P M Iacono, 'Class Actions and Products Liability in Ontario: What Will Happen?' (1991) 3 *Canadian Insurance Law Review* 99, 103.

¹⁵⁶ 'The high cost of notifying absent class members when potential recovery is very small deters entrepreneurial attorneys from bringing meritorious suits': Macey and Miller, op cit (fn 102) 4.

¹⁵⁷ Section 17(2).

of the class members, the number of class members, the places of residence of class members and any other relevant matter.¹⁵⁸

The Court is empowered to order the defendant to deliver the notice 'where that is more practical'.¹⁵⁹ It may also 'make any order it considers appropriate as to the costs of any notice . . . including an order apportioning costs among parties'.¹⁶⁰

The Ontario regime allows courts to ensure that the implementation of a procedure which is designed to protect the interests of the class members does not result in the creation of 'a barrier to procedures [such as class actions] which, in many circumstances, may be the only way any individual or group will have access to relief'.¹⁶¹

Conclusion

Contingency fee arrangements can provide a satisfactory solution to the considerable disincentive to the commencement of representative proceedings created by the imposition on the representative plaintiff of personal liability for the considerable legal expenses that are incurred in conducting the class suit.

The financial incentives which contingency fee agreements offer to lawyers to act in a manner which may not accord with the best interests of their clients must, however, be acknowledged. A reasonably adequate solution to this problem of conflict of interest can, however, be found in judicial approval of class settlements and judicial determination of the class lawyer's remuneration. The extent of this measure's success will be largely dependent on the willingness of Australian judges to assume a very active role, pursuant to which they do not simply restrict themselves to the issues or problems identified by the parties before them. Should it be felt that judicial scrutiny of the class lawyer's conduct does not, on its own, provide the required level of protection, the use of special 'guardians' should be considered.

It is, however, crucial not to lose sight of the fact that contingency fees cannot provide a complete solution to the costs-related problems faced by potential class representatives. The representative plaintiff's liability for the respondent's costs in the event of a victory by the respondent remains. The

¹⁵⁸ Section 17(3). Once a decision is made to require notice, the court has been vested with the discretion to choose among different methods of providing notice: s 17(4). Section 33Y(5) of the Act is more direct on this issue as it does not permit the Court to 'order that notice be given personally to each group member unless it is satisfied that it is reasonably practicable, and not unduly expensive, to do so'.

¹⁵⁹ Section 22(1).

¹⁶⁰ Section 21.

¹⁶¹ W A Bogart, 'Questioning Litigation's Role — Courts and Class Actions in Canada' (1987) 62 *Indiana Law Journal* 665, 694. See also, V Morabito, 'Class Actions — the Right to Opt Out Under Part IVA of the *Federal Court of Australia Act* 1976 (Cth)' (1994) 19 *MULR* 615, 645–6; B M DeBelle, 'Class Actions for Australia? Do They Already Exist?' (1980) 54 *ALJ* 508, 513–4; Macey and Miller, *op cit* (fn 102) 28–9; J S Emerson, 'Class Actions' (1989) 19 *VUWLR* 183, 203–4; W Fisch, 'Notice, Costs, and the Effect of Judgment in Missouri's New Common-Question Class Action' (1973) 38 *Missouri Law Review* 173; American Bar Association, Section of Litigation, 'Report and Recommendations of the Special Committee on Class Action Improvements' (1986) 110 *FRD* 195, 208.

unavailability of a monetary fund from which to deduct the difference between the class lawyer's higher than normal fee, as permitted under a contingency fee arrangement, and the costs recovered from the unsuccessful respondent, will, in many cases, discourage legal suits seeking non-monetary relief on behalf of a class. This problem becomes more pronounced in schemes such as the one proposed by the author which envisage the introduction of an 'each party bears his/her own costs' principle. Possible means of dealing with the problems left untouched by the introduction of contingency fees will be considered in Parts IV and V of this article.

IV THE COSTS INDEMNITY RULE AND CLASS ACTIONS

Although 'the objectives of the costs indemnity rule have never been clearly defined',¹⁶² it is possible to identify three major arguments that are commonly put forward in favour of the rule by its supporters.

One rationale for the costs indemnity rule is that,

it has been a principle of English and Australian law that if a person has the right he or she claims to have, he or she should not have to pay to establish it. Costs should be borne by the person who insists on a right he or she turns out not to have.¹⁶³

An obvious response to this argument is that, in practice, the costs indemnity rule falls short of providing full compensation to the successful party as he/she is reimbursed by the adversary for only 60 to 70 per cent of the total costs incurred.¹⁶⁴ Supporters of the rule have justified less than full compensation on the basis that awarding 'costs on the party and party scale will not afford the winner complete indemnity and thus helps ensure that the action or defence is not only meritorious, but is of sufficient importance to the successful party to justify this expense'.¹⁶⁵

A number of commentators believe, however, that,

¹⁶² Australian Law Reform Commission, *Who Should Pay? A Review of the Litigation Costs Rules* (Issues Paper 13, October 1994) para 3.2 ('Costs Rules')

¹⁶³ Senate Standing Committee on Legal and Constitutional Affairs, *Cost of Legal Services and Litigation — Discussion Paper No 3: Contingency Fees* (1991) para 2.9 ('Senate Discussion Paper'). See also, Costs Rules, op cit (fn 162) para 5.2; P J Mause, 'Winner Takes All: A Re-examination of the Indemnity System' (1969) 55 *Iowa Law Review* 26, 26-7; A Ehrenzweig, 'Reimbursement of Counsel Fees and the Great Society' (1966) 54 *California Law Review* 792, 797; L A Kuenzel, 'The Attorney's Fee: Why Not a Cost of Litigation?' (1963) 49 *Iowa Law Review* 75, 82-3; M S Stein, 'Is One-Way Fee Shifting Fairer than Two-Way Fee Shifting?' (1992) 141 *FRD* 351, 352; Rowe, op cit (fn 145) 888; F Vargo, 'The American Rule on Attorney Fee Allocation: The Injured Person's Access to Justice' (1993) 42 *American University Law Review* 1567, 1630; Action Plan, op cit (fn 152) para 5.6.1.

¹⁶⁴ See DeBelle, op cit (fn 161) 509; J Epstein, 'The Key to the Courthouse: the Introduction of Contingency Fees in Victoria' (1987) 61 *LIJ* 1264, 1265; Grouped Proceedings, op cit (fn 5) para 254; H M Kritzer, 'The English Rule' (1992) 6 *American Bar Association Journal* 54, 58; Costs Rules, op cit (fn 162) para 4.3.

¹⁶⁵ T A Cromwell, 'An Examination of the Ontario Law Reform Commission Report on Class Actions' (1983) 15 *Ottawa Law Review* 587, 589-90. See also Action Plan, op cit (fn 152) para 5.60; Costs Rules, op cit (fn 162) para 1.6.

the real rationale for recoupment is not concern for the welfare of the plaintiff. It is rather that litigation is essentially disfavoured and that a kind of punishment should be inflicted on the party in the wrong, who is presumed to be the one who loses.¹⁶⁶

The compensation rationale is based on the principle 'that a party should be indemnified because he or she is successful and that this is appropriately done by the unsuccessful party'.¹⁶⁷ This philosophy underlying the loser pays rule has been cogently attacked on the basis that 'by granting indemnity to the party who succeeds on the merits, losers are penalised simply for having lost, no matter how sound their decision to litigate or to resist settlement may have been'.¹⁶⁸

The second argument in favour of the costs indemnity rule is that without it our courts would be 'inundated' with unmeritorious claims and defences as litigants would no longer be faced with the prospect of an adverse costs order.¹⁶⁹

A number of problems with this argument are evident. One weakness of this argument is that it,

assumes that the abusing party would recognise the frivolous nature of its claim or defense prior to the outcome of litigation. Many claims and defenses are asserted by parties based on a good-faith belief in their validity. Thus, any rationale that would automatically label a losing litigant's claim or defense as frivolous goes too far.¹⁷⁰

Furthermore, those Australian jurisdictions that have adopted the American rule do not appear to have experienced the problem of excessive unmeritorious cases.¹⁷¹

But the most fundamental problem with the use of the costs indemnity rule as a means of dealing with unfounded claims is that it creates risk and uncer-

¹⁶⁶ P H Corboy, 'Contingency Fees: The Individual's Key to the Courthouse Door' (1976) 2 *Litigation* 27, 31. See also Vargo, op cit (fn 163) 1633; N Gold, 'Controlling Procedural Abuses: The Role of Costs and Inherent Judicial Authority' (1977) 9 *Ottawa Law Review* 44, 53. Punishment can also be seen as the underlying rationale of some of the exceptions to the costs indemnity rule as where 'the successful party has unnecessarily or unreasonably commenced, continued or encouraged the litigation or has acted improperly': Costs Rules, op cit (fn 162) para 2.2

¹⁶⁷ Costs Rules, op cit (fn 162) para 5.2.

¹⁶⁸ G A Hicks, 'Statutory Damage Caps are an Incomplete Reform: A Proposal for Attorney Fee Shifting in Tort Actions' (1989) 49 *Louisiana Law Review* 763, 791. See also Vargo, op cit (fn 163) 1622.

¹⁶⁹ TPC Final Report, op cit (fn 71) 160; Action Plan, op cit (fn 152) para 5.61; Senate Discussion Paper, op cit (fn 163) para 2.9; Ehrenzweig, op cit (fn 163) 797; Kuenzel, op cit (fn 163) 82-3; Cromwell, op cit (fn 165) 589; Costs Rules, op cit (fn 162) para 5.9.

¹⁷⁰ Vargo, op cit (fn 163) 1632.

¹⁷¹ Costs Rules, op cit (fn 162) para 1.6. These jurisdictions include the federal family law jurisdiction, administrative review by tribunals and consumer claims tribunals: see, Costs Rules, op cit (fn 162) paras 2.22, 2.28; Grouped Proceedings, op cit (fn 5) para 265; Action Plan, op cit (fn 152) para 5.60.

tainty for *all* litigation.¹⁷² The barriers to the commencement of meritorious litigation 'erected' by the rule were aptly summarised by Rowe:

The English rule works harshly in close cases, especially when a plaintiff was entirely reasonable in pursuing a claim that turned out at trial to lose. As a result, the rule may excessively discourage the pressing of plausible but not clearly winning claims, particularly when the prospective plaintiffs are strongly risk averse. This effect is especially likely to fall heavily on middle class people with something to lose but not so many assets that they can tolerably afford to lose much.¹⁷³

The uncertainty faced by potential litigants is not limited to the ultimate outcome of the case, but extends to the issue of the amount of costs that may be awarded against them, should they be unsuccessful at the trial.¹⁷⁴

If the commencement of dubious cases is regarded as a genuine problem, it should be tackled directly and not indirectly through a crude and indiscriminatory measure such as the 'loser pays' rule. In relation to class suits brought under the Act, for instance, reliance can be placed by the court on s 33ZG which makes it clear that nothing in Part IVA affects,

the Court's powers under provisions other than this Part, for example, its powers in relation to a proceeding in which no reasonable cause of action is disclosed or that is oppressive, vexatious, frivolous or an abuse of the process of the Court.¹⁷⁵

Another argument that is commonly raised in support of the costs indemnity rule is that 'because it adds to the amount at stake in litigation, [it] encourages settlement between the parties . . .'.¹⁷⁶ The effect of different costs rules on the settlement of legal claims has been the subject of extensive studies by economic scholars. Unfortunately, no consensus has been arrived at by these commentators as to the impact of the costs indemnity rule on a litigant's decision to settle. Some economic scholars are of the view that the loser pays rule leads to more settlements than the American rule.¹⁷⁷ Other commentators

¹⁷² 'The fact that the costs indemnity rule acts as a barrier to justice appears to be acknowledged in those courts or tribunals where the rule is not applied. It is perhaps significant that, for the most part, these are tribunals that determine consumer or human rights claims, or resolve disputes between individuals and government authorities — matters in which access to justice might be thought to be a high priority': Action Plan, op cit (fn 152) para 5.63.

¹⁷³ Rowe, op cit (fn 145) 888. See also Senate Discussion Paper, op cit (fn 163) para 2.7; Corboy, op cit (fn 166) 34; Hicks, op cit (fn 168) 789–90; Kritzer, op cit (fn 164) 55, 58; J C Hause, 'Indemnity, Settlement and Litigation, or I'll be Suing you' (1989) 18 *Journal of Legal Studies* 157, 176.

¹⁷⁴ 'This uncertainty makes it almost impossible for a party to budget for the total cost of litigation. Uncertainty as to the amount of costs that may be awarded under the costs indemnity rule may discourage people from litigating': Costs Rules, op cit (fn 162) para 5.5.

¹⁷⁵ This provision was based on a recommendation of the ALRC: see s 6 of the ALRC's Draft Bill.

¹⁷⁶ Action Plan, op cit (fn 152) para 5.61.

¹⁷⁷ See Hause, op cit (fn 173) 167–8; R A Posner, 'An Economic Approach to Legal Procedure and Judicial Administration' (1973) 2 *Journal of Legal Studies* 399, 428.

have reached the opposite conclusion.¹⁷⁸ A third school of thought adheres to the view 'that the settlement rate will be unaffected by the legal rule because the parties will contract around the standard to maximize their expected wealth'.¹⁷⁹

This argument in favour of the loser pays rule is, of course, based on the assumption that an increase in the number of settlements is a desirable feature. Settlements produce a number of benefits such as the avoidance of the high costs of court proceedings for both litigants; the reduction in the consumption of finite judicial resources and allowing 'those matters that cannot be settled to come before the courts more quickly'.¹⁸⁰

But the attainment of these benefits does not necessarily guarantee the attainment of a more fundamental goal of any legal system, namely, the 'moral concept of justice being done between the parties'.¹⁸¹ After conducting an empirical study of English settlement practices, Genn concluded that,

an assumption that out of court settlements simply reflect the outcome that would have occurred at trial, but without the inevitable delay and expense of formal proceedings, ignores what this study has shown to be the crucial importance of unequal resources and opportunities, and other extra-legal factors, which may exert a greater influence outside the courtroom than inside.¹⁸²

Genn's study revealed that the factors referred to in the passage above, such as unequal resources, result in settlements which, in most cases, heavily favour defendants.¹⁸³ These findings are not surprising. All litigation involves uncertainty. The prospect of having to pay a substantial portion of the costs incurred by one's adversary, in the event of an unsuccessful outcome, may prompt a plaintiff to settle cheaply.¹⁸⁴ The pressure to settle for amounts which do not reflect the merits of the plaintiff's claim is exacerbated where the plaintiff has very limited resources or where the opponent has, at his/her

¹⁷⁸ See R A Posner, 'Comment on Donohue' (1988) 22 *Law and Society Review* 927, 928; S Shavell, 'Suit, Settlement, and Trial: A Theoretical Analysis under Alternative Methods for the Allocation of Legal Costs' (1982) 11 *Journal of Legal Studies* 55, 65.

¹⁷⁹ J J Donohue III, 'Opting for the British rule, or if Posner and Shavell Can't Remember the Coase Theorem, Who Will?' (1991) 104 *Harvard Law Review* 1093, 1095.

¹⁸⁰ Costs Rules, op cit (fn 162) para 5.18. See also H Bedlin and P Nejelski, 'Unsettling Issues About Settling Civil Litigation' (1984) 68 *Judicature* 9, 11; J C Alexander, 'Do the Merits Matter? A Study of Settlements in Securities Class Actions' (1991) 43 *Stanford Law Review* 497, 498.

¹⁸¹ H Genn, *Hard Bargaining Out of Court Settlement in Personal Injury Actions* (London, 1987) 168.

¹⁸² Id 169.

¹⁸³ She discovered that a severe 'power imbalance' exists between plaintiffs and defendants as injured people tend to be 'one shot players' while most defendants can be accurately described as 'repeat players' with extensive experience in litigation: id 34-5. In this scenario, it came as no great surprise that Genn's study revealed that two-thirds of the injured parties accepted the first offer put forward by the defendant: id 106-7. See also, Kritzer, op cit (fn 164) 56.

¹⁸⁴ 'While early settlements may be the result of generous offers, it is more likely that plaintiffs are inclined to accept whatever is offered to avoid the risk of cost-shifting. To quote Judge Devlin . . . the unassisted litigant "must take what is offered to him and be glad that he has got something": Kritzer, op cit (fn 164) 56.

disposal, far greater resources than the plaintiff.¹⁸⁵ Another incentive to accept whatever offer is put forward by the defendant is provided by the rules of a number of Australian courts, pursuant to which if a plaintiff receives a judgment for a sum that is no greater than the amount of damages previously offered by the defendant, the plaintiff becomes liable for the costs incurred by the defendant following the making of the settlement offer.¹⁸⁶

In light of the considerations above, Hicks was entitled to complain that,

the risks of litigating rather than settling even a strong case are comparatively great, and the additional threat of paying prevailing party fees in all cases of loss, or of failure to obtain at trial an award as great as an earlier settlement offer, would unduly burden plaintiffs' trial decisions. True two-way indemnity weighs as heavily on good faith refusals to settle as it does on unreasonable refusals to settle. A fee shifting scheme must be more discriminating than that scheme in its effects on different classes of unsuccessful plaintiffs.¹⁸⁷

The disincentives to the commencement of legal proceedings and the strong pressures to accept cheap settlements created by the application of the costs indemnity rule are intensified in class suits. As outlined in Part I, in an unsuccessful class suit the representative plaintiff becomes liable not only for the costs incurred by the class, but also for any adverse costs order. In individually non-recoverable claims, the liability arising from an award of costs against the class will usually exceed the value of the class plaintiff's claim. In individually recoverable claims, any award of costs in favour of the class suit's opponent is likely to be of greater magnitude than an adverse costs order in individual proceedings as a result of the greater complexity of class actions. Consequently, 'the existing costs rules have the effect of discouraging all class actions, for reasons having nothing to do with their propriety or merits'.¹⁸⁸

As outlined in Parts II and III, contributions from class members and contingency fee arrangements do not provide a satisfactory solution to the disincentive to class suits created by the prospect of an adverse costs order. Recognition of the unfortunate fact that the costs indemnity rule adversely affects access to justice by class members prompted the OLRC to recommend the use of the American rule in class suits.¹⁸⁹ The philosophy underlying the American rule was neatly summarised by the US Supreme Court:

Since litigation is at best uncertain one should not be penalized for merely

¹⁸⁵ 'In some cases it may be possible for a wealthier party to increase pressure on the other party to settle or withdraw by adding to the costs of an action through the use of procedural rules and delaying tactics': Costs Rules, op cit (fn 162) para 1.6. See also Genn, op cit (fn 181) 169: 'the legal rules of evidence and procedure . . . can be mobilized efficiently against fainthearted plaintiffs . . . to increase the likelihood of abandonment, to reduce the likelihood of trial, and to encourage capitulation on the basis of discounted and reduced offers'.

¹⁸⁶ See eg, O 26 of Victoria's *Supreme Court Rules*.

¹⁸⁷ Hicks, op cit (fn 168) 792.

¹⁸⁸ Ontario Report, op cit (fn 1) 663.

¹⁸⁹ Id 704.

defending or prosecuting a lawsuit, and that the poor might be unjustly discouraged from instituting actions to vindicate their rights if the penalty for losing includes the fees of their opponents' counsel.¹⁹⁰

Before considering the third major costs rule, the 'one-way' rule, it is important to examine the reasons that the ALRC put forward for its conclusion 'that a no costs rule should not be adopted for grouped proceedings'.¹⁹¹ In addition to placing reliance on the general arguments in favour of the loser pays rule, which were canvassed above, the ALRC argued that 'a successful applicant may incur considerable costs in pursuing a case; if no costs can be recovered, any monetary relief may well be eaten up by costs'.¹⁹²

A number of arguments can be put forward to rebut the ALRC's reasoning. The experience in the US indicates that in common fund cases, legal fees and costs do not usually consume a high proportion of the fund obtained by the class representative on behalf of the class.¹⁹³ It should also be noted that the mechanism established pursuant to s 33ZJ(2) allows the financial burdens of the class suits to be shared among the beneficiaries of the 'fruits' of the litigation. Consequently, the risk of solicitor-client costs 'eating up' the monetary relief is considerably lower in representative proceedings than it is in individual proceedings.¹⁹⁴ Furthermore, removing the risk of an adverse costs order reduces substantially the pressures which currently induce plaintiffs to accept unreasonable settlement offers. Plaintiffs are therefore placed

¹⁹⁰ *Fleishmann Distilling Corp v Maier Brewing Co* 386 US 714 (1967), 718. See also, *Action Plan*, op cit (fn 152) para 5.62 ('the principal argument against the costs indemnity rule is that it disadvantages people of ordinary means involved in or contemplating litigation, particularly against wealthier opponents').

¹⁹¹ *Grouped Proceedings*, op cit (fn 5) para 267. Ontario's and Quebec's class action legislation have both retained the costs indemnity rule. However, s 31(1) of Ontario's *Class Proceedings Act* 1992 provides that 'in exercising its discretion with respect to costs . . . the court may consider whether the class proceeding was a test case, raised a novel point of law or involved a matter of public interest'. In Quebec, amendments in 1982, 'while retaining the two-way costs rule, greatly reduced the potential exposure for plaintiffs. A generally applicable rule in Quebec which charged the loser with paying one percent of the amount in question for cases exceeding \$100 000 was made inapplicable to class actions. Further, costs in class actions are now determined by reference to the tariff of costs which applies to actions involving amounts of \$1000 to \$3000 regardless of the amount actually in issue': Bogart, op cit (fn 161) 687.

¹⁹² *Grouped Proceedings*, op cit (fn 5) para 267.

¹⁹³ 'On the average, class action plaintiffs' attorneys received only 14.7% of the 6.4 billion dollars that plaintiffs recovered in class action suits over the past twenty years': Stasko, op cit (fn 127) 1668. See also B I Bertelsen, M S Calfee, and G W Connor, 'The Rule 23(b)(3) Class Action: An Empirical Study' (1974) 62 *Georgetown Law Journal* 1123, 1153-4, 1164-5; A R Miller, 'Of Frankenstein Monsters and Shining Knights: Myth, Reality and the "Class Action Problem"' (1979) 92 *Harvard Law Review* 664, 667; 'Responses to the Rule 23 Questionnaire of the Advisory Committee on Civil Rules' (1978) 5 *Class Action Reports* 3, 8; B Moore, 'The ABA, the Congress and Class Actions: A Report' (1974) 3 *Class Action Reports* 36, 51; 'Developments' (1978) 5 *Class Action Reports* 331, 357-8.

¹⁹⁴ This conclusion follows logically from two factors: the costs are deducted from the total damages awarded to the class and the costs incurred in a class suit 'will be less than the sum total of costs which would be incurred if separate proceedings were initiated by all or even some group members': *Grouped Proceedings*, op cit (fn 5) para 252.

in a stronger bargaining position and may be able to obtain compensation which more accurately reflects the merits of their claims.¹⁹⁵

The other major argument in favour of the costs indemnity rule articulated by the ALRC was that,

if a no costs rule related only to grouped proceedings and not to individual proceedings, a person with a claim which justified individual proceedings in economic terms, and who was reasonably confident of success, would not choose to commence proceedings for others in a similar situation because costs could not be recovered from the other side.¹⁹⁶

This argument is simply inapplicable to class action regimes, such as the ones proposed by the author and the ALRC itself, which envisage both public funding of class suits and contingency fee arrangements and which, therefore, offer financial benefits that are not available to individual litigants.

One-Way Costs Rule

A costs regime pursuant to which an award of costs can be made against an unsuccessful defendant, but not against an unsuccessful class plaintiff, would achieve the desirable result of enhancing access to justice and, at the same time, would address the concern of the ALRC that successful litigants are not compensated, under the American rule, for the costs incurred in enforcing their rights.¹⁹⁷

The one-way costs rule described above is extensively used in the US as an exception to the American rule.¹⁹⁸ Over 150 federal statutes 'mandate one-way pro-plaintiff fee shifting'¹⁹⁹ while, at the state level, a survey conducted in 1984 revealed that 'fifty-four percent of the 1974 statutes identified as mandatory fee shifting statutes among the 4000–5000 statutes surveyed, designated the prevailing plaintiff as the beneficiary of the statute'.²⁰⁰

The justification for one-way fee shifting legislation, in favour of plaintiffs, that is most commonly put forward by American commentators is that it encourages public interest litigation.²⁰¹ Other arguments in favour of this pro-plaintiff rule have included the rule's ability to equalize 'the litigating

¹⁹⁵ 'In the "practical" application of a two-way shift system, the injured party seldom receives full compensation while the defendant is almost always "overcompensated". Thus, injured people obtain full compensation in theory but not in practice': Vargo, *op cit* (fn 163) 1630.

¹⁹⁶ Grouped Proceedings, *op cit* (fn 5) para 267.

¹⁹⁷ See Hicks, *op cit* (fn 168) 793–6; J Leubsdorf, 'Recovering Attorney Fees as Damages' (1986) 38 *Rutgers Law Review* 439.

¹⁹⁸ 'The vast majority of fee-shifting statutes in the United States . . . provide for one-way shifts in favour of plaintiffs': Vargo, *op cit* (fn 163) 1629.

¹⁹⁹ Stein, *op cit* (fn 163) 351.

²⁰⁰ Hicks, *op cit* (fn 168) 795.

²⁰¹ See Mause, *op cit* (fn 163) 38–42; Rowe, *op cit* (fn 145) 888; Vargo, *op cit* (fn 163) 1629; R V Percival and G P Miller, 'The Role of Attorney Fee Shifting in Public Interest Litigation' (1984) 47 *Law and Contemporary Problems* 233, 239–41.

strengths of the parties'²⁰² and the notion that a party who suffers should be made whole.²⁰³

The SALRC recommended the use of a one-way pro-plaintiff costs rule in class suits.²⁰⁴ The SALRC was of the view that the unfairness of this rule in relation to successful defendants would be mitigated by the requirement of judicial authorisation before a class suit can be allowed to proceed and by 'the fact that the defendants to class actions will, almost without exception, be public authorities or large corporations which will not find the costs of litigation ruinous'.²⁰⁵ The SALRC also drew attention to the 'serious injustice now done to great numbers of people who suffer loss and have no effective remedy'.²⁰⁶

As will be shown in Part V, the notion that class actions can be regarded as having a 'public interest' dimension provides a compelling argument for the establishment of a public fund to provide financial assistance to meritorious class suits; but it is not sufficient to justify the unequal treatment of litigants which a one-way costs rule dictates. The arguments in favour of a rejection of the SALRC's proposal were best summarised by the OLRC, which indicated that,

undoubtedly, a 'one-way' costs rule would facilitate class actions. Yet it would do so at the price of unfairness to defendants. It may be argued that, as in the United States, such a rule might be justifiable, on a private enforcement theory, in certain substantive law areas, and particularly where a defendant has violated a regulatory statute. However, we believe that the uneven treatment inherent in a 'one-way' rule is not supportable in a class action procedure that is intended to have a broad application to all civil causes of action.²⁰⁷

Furthermore, an award of costs against any losing party 'has about it an air of punishment. It smacks of a penalty for the 'offence' of having been involved in the litigation'.²⁰⁸

²⁰² Rowe, *op cit* (fn 145) 888. 'Such considerations seem to underlie much existing fee shifting, demonstrated in federal minimum wage and civil rights cases and under the federal Equal Access to Justice Act': *id* 888-9.

²⁰³ See Mause, *op cit* (fn 163) 30; Leubsdorf, *op cit* (fn 197) 459; T D Rowe, 'The Legal Theory of Attorney Fee Shifting: A Critical Overview' [1982] *Duke Law Journal* 651, 657-9.

²⁰⁴ Law Reform Committee of South Australia, *Report Relating to Class Actions* (Report No 36; 1977) ('SALRC Report') 8.

²⁰⁵ *Ibid*.

²⁰⁶ *Ibid*. See also A Homburger, 'State Class Actions and the Federal Rule' (1971) 71 *Columbia Law Review* 609, 654.

²⁰⁷ Ontario Report, *op cit* (fn 1) 707. See also Stein, *op cit* (fn 163) 359 ('One-way fee shifting should carry a presumption of unfairness'); Grouped Proceedings, *op cit* (fn 5) para 264 ('it would not be equitable to enable applicants to commence grouped proceedings in the knowledge that they may recover costs from the respondent if they succeed but would not be liable to contribute to the respondent's costs if unsuccessful').

²⁰⁸ Corboy, *op cit* (fn 166) 33-4.

Conclusion

The costs indemnity rule should be rejected on both conceptual and practical grounds. The undisclosed philosophy underlying this rule, of punishing the losing litigants by ordering them to pay a significant proportion of the costs incurred by the successful opponent, is difficult to accept. Equally difficult to accept is the rule's practical effect of taking access to our legal system out of the reach of most individuals, including those wishing to take legal action on behalf of a group of 'aggrieved' persons.

The pro-plaintiff one-way costs rule addresses the disincentives to litigation generated by the costs indemnity rule, by allowing successful plaintiffs to recover part of their costs from their opponents while, at the same time, eliminating the risk of an unsuccessful plaintiff having to pay the litigation costs of his/her successful adversary. However, the conceptual problems inherent in any costs rule based on a loser pays principle remain. Indeed, they are intensified under a one-way costs rule as it is only one of the litigants, the defendant, who is deemed to deserve punishment in the event of loss at the trial.

V FINANCING OF CLASS SUITS BY THIRD PARTIES

The remaining means of dealing with the costs disincentives to representative proceedings is financing by third parties. Two major types of financing by third parties will be considered in this Part: the existing legal aid regimes and special funds for representative proceedings.

Legal Aid

The ALRC was of the view that 'existing legal aid arrangements are not appropriate for grouped proceedings'.²⁰⁹ A number of persuasive arguments can be put forward to support the ALRC's conclusion.

The general priorities for legal aid assistance include,

whether a basic human right is in jeopardy; whether alternative dispute resolution options have been utilised; the applicant's means and ability to contribute towards costs; and the likelihood of a favourable outcome in the contemplated proceedings.²¹⁰

The application of these criteria and the necessarily limited funds that are diverted to legal aid schemes,²¹¹ have had three major effects. One effect is that most of the successful applications for legal aid concern criminal law proceedings. As was recently noted by the ALRC:

In 1992-93, 62% of applications were for criminal matters, while 72% of

²⁰⁹ Grouped Proceedings, op cit (fn 5) para 305.

²¹⁰ ALRC, *Equality Before the Law: Justice for Women* (Report No 69, Part 1; 1994) para 4.7, fn 10 ('Justice for Women').

²¹¹ 'There will never be enough resources to meet completely the community's need for legal assistance': Action Plan, op cit (fn 152) para 9.41.

approvals were. Conversely, family law matters constituted 27% of applications but only 21% of approvals, while civil matters constituted 11% of applications and only 7% of approvals.²¹²

A second common feature of Australian legal aid schemes is that they do not usually extend to costs awarded against the recipients of legal aid.²¹³

The other common characteristic of legal aid schemes that is of direct relevance for present purposes is the application of strict eligibility criteria, in relation to the 'means test',²¹⁴ which have created 'a litigious 'poverty trap' which catches people who are too rich to qualify for legal aid but not rich enough to pay lawyers' fees'.²¹⁵ The means test creates additional problems in the context of representative procedures. The ALRC has indicated that this test is applied not just in relation to the financial means of the representative plaintiff but also to the means of all class members.²¹⁶ This requirement creates obvious administrative problems, especially in opt out schemes which do not require the identification of, and the express consent to the bringing of the class suit by, the class members.²¹⁷

But the most fundamental problem with the use of legal aid schemes as measures to reduce the costs barriers confronted by representative plaintiffs is that,

the principle upon which legal aid is granted in individual actions — the impecuniosity of the plaintiff — does not address the economic problem faced by a prospective plaintiff in the class action context. His dilemma is not necessarily a lack of financial resources, but rather the fact that the potentially enormous costs of litigation so exceed the amount of his per-

²¹² Justice for Women, op cit (fn 210) para 4.12, fn 31. See also, *Funding Litigation*, op cit (fn 71) 14–5; TPC Draft Report, op cit (fn 71) 236. It has been recently announced that the Commonwealth government 'will provide an additional \$16.8 million over the next four years to legal aid commissions to enable commissions to deliver more services in civil and family law': Attorney-General's Department, *The Justice Statement* (May 1995) 103 ('Justice Statement').

²¹³ *The Legal Aid Commission Act 1979* (NSW) provides that, except in certain circumstances, where a court or tribunal orders a legally assisted person to pay costs, the Legal Aid Commission is liable to pay the costs, but only up to a specified sum (now \$12 500) or such sum as the Commission may determine from time to time. Most other legal aid commissions are not required to pay all or any part of the costs awarded against an assisted party but may choose to do so': Costs Rules, op cit (fn 162) para 4.15. One of the AJAC's recommendations was that 'the Australian Legal Aid Commission should consider whether it is desirable and feasible that a costs indemnity should be introduced beyond New South Wales for legally assisted persons in civil litigation': Action Plan, op cit (fn 152) para 9.76.

²¹⁴ 'Applicants are means tested against assets and income thresholds. Applicants with disposable income of less than the income threshold and with assessable assets less in value than the assets thresholds qualify for non-contributory legal assistance': Senate Standing Committee on Legal and Constitutional Affairs, *Costs of Legal Services and Litigation — Discussion Paper No 7: Legal Aid — 'For Richer and For Poorer'* (1992) para 3.21 ('Legal Aid Paper').

²¹⁵ Senate Discussion Paper, op cit (fn 163) para 2.4 See also B J Birrell, 'Contingent Fees — A Viable Alternative?' (1981) 55 ALJ 333, 338 ('there is a growing criticism . . . that unless a person is very wealthy or very poor, he or she is not likely to obtain adequate legal representation for tort-related cases').

²¹⁶ Grouped Proceedings, op cit (fn 5) para 304.

²¹⁷ As a result of the lack of 'consent of group members at the outset, it will be very expensive, and in some cases impossible, to assess the means of all group members in order to apply any kind of means test to the granting of aid': id para 305.

sonal stake that, regardless of his resources, it would not be economically rational to initiate a class action.²¹⁸

In light of this inadequacy of legal aid schemes, as a source of funds for class suits, the desirability of establishing a special public fund for representative actions will now be considered.

Special Public Fund For Class Actions

The notion of special funds to finance class suits has been embraced in Ontario and Quebec, the only two Canadian jurisdictions which have detailed legislative frameworks governing class suits. In the Australian context, both the SALRC and the ALRC proposed the establishment of class action funds. The features of each of these four schemes will now be considered.

Quebec

The enactment, in 1978, of *An Act Respecting the Class Action* 1978 saw the creation of the *Fonds d'aide aux recours collectifs* ('the Fonds'), a government agency that is entrusted with the function of providing financial assistance to representative plaintiffs.

Any representative plaintiff can apply to the Fonds for financial assistance to cover disbursements, the cost of paying the class lawyer and the costs of the defendant that are awarded against the class in the event of an unfavourable result for the class.²¹⁹ One of the eligibility criteria applied by the Fonds is 'whether the class action may be brought or continued without such assistance'.²²⁰ In the case of class actions that have not yet been judicially approved at the 'certification'²²¹ stage, 'the Fonds must consider whether it is probable that there is a valid cause of action and the probability that the class action will be brought. In essence, the former factor amounts to a form of preliminary assessment of the merits of the class action'.²²²

Between 1978 and 1990, 301 of the 492 applications for financial assistance received by the Fonds were successful.²²³ In the event of loss at the trial for the legally assisted class, the costs and disbursements incurred by the class suit and, if the plaintiff lacks adequate financial resources to pay the defendant's costs,²²⁴ any costs awarded in favour of the successful defendant are borne by the Fonds.²²⁵ In the event of a successful class suit, the costs recovered from the defendant must be paid to the Fonds.²²⁶ Furthermore, 'the Fonds is

²¹⁸ Ontario Report, op cit (fn 1) 661.

²¹⁹ See H P Glenn, 'Class Actions in Ontario and Quebec' (1984) 62 *Canadian Bar Review* 247, 259; Grouped Proceedings, op cit (fn 5) para 307.

²²⁰ See s 23 of *An Act respecting the Class Action* 1978.

²²¹ 'In the United States and Quebec, a class action may not proceed until a preliminary hearing, called a certification or authorisation hearing respectively, has determined the propriety of that form of suit': Grouped Proceedings, op cit (fn 5) para 144.

²²² Ontario Report, op cit (fn 1) 695.

²²³ See Fonds d'aide aux recours collectifs, *Rapport Annual 1989-90*, 27.

²²⁴ *Report of the Attorney-General's Advisory Committee on Class Action Reform* (Ontario; 1990) 62 ('Advisory Committee').

²²⁵ Glenn, op cit (fn 219) 259.

²²⁶ Ontario Report, op cit (fn 1) 695; Bogart, op cit (fn 161) 686.

regularly "topped up" as a result of legislative provisions that require a percentage of class action awards to be paid into the fund'.²²⁷

Since contingency fee arrangements are permitted in Quebec, they can be combined with financial assistance from the Fonds. As Glenn explained:

There is no need for counsel to finance litigation by bearing his or her own costs in the event of loss if the *Fonds* will pay normal fees for such an unsuccessful case. The *Fonds* may thus be looked to for normal support in case of loss, the judgment for richer rewards on a contingency basis in the event of success.²²⁸

Ontario

The introduction of a legislative class action regime in Ontario in 1992 was accompanied by the enactment of the *Law Society Amendment Act (Class Proceedings Funding)* 1992 which established a public funding mechanism for class actions.²²⁹

Pursuant to this Act, a Class Proceedings Fund has been established for the following purposes:

- (1) Financial support for plaintiffs to class proceedings and to proceedings commenced under the *Class Proceedings Act* 1992, in respect of disbursements related to the proceeding.
- (2) Payments to defendants in respect of costs awards made in their favour against plaintiffs who have received financial support from the Fund.²³⁰

The second use of the Fund, set out above, of providing successful applicants with total immunity in relation to an adverse costs order is activated by a rather odd procedure. Representative plaintiffs wishing to receive financial assistance from the Fund must apply to the Class Proceedings Committee, the agency that administers the Fund,²³¹ 'for financial support from the Class Proceedings Fund in respect of disbursements related to the proceeding'.²³² Once the Committee decides to provide the applicant with some financial assistance in relation to the class suit's disbursements, the Committee automatically becomes liable for any costs that are awarded against the financially assisted class plaintiff, no matter how modest the grant from the Fund happened to be.²³³ This means that,

it may be anticipated that many representative plaintiffs, if refused disbursement funding from the Fund, will not proceed with the class action. This could lead to the curious situation that the most important and significant step in class proceedings may not be in court, but will be the class representative's application to the Class Proceedings Committee for what will be (in form) a request for disbursement funding, but is in reality a desire

²²⁷ Watson, op cit (fn 98) 367.

²²⁸ Glenn, op cit (fn 219) 259.

²²⁹ See also 'Regulations made under the Law Society Act' — O Reg 771/92.

²³⁰ *Law Society Act* 1990, s 59.1(2).

²³¹ The grants approved by the Committee are actually paid by the Board of the trustees of the Law Foundation of Ontario: see *Law Society Act* 1990, ss 59.3(3), (6); Class Proceedings Committee, *Practice Direction 1* (February 1993) para 12.

²³² *Law Society Act* 1990 s 59.3(1).

²³³ *Law Society Act* 1990 s 59.4(1), (2).

to obtain an immunity from the 'downside risk' of liability for the defendant's costs.²³⁴

The criteria that are to be considered by the Committee in relation to a class plaintiff's application for funding include the merits of the plaintiff's case, whether the plaintiff has made reasonable efforts to raise funds from other sources, whether the plaintiff has a clear and reasonable proposal for the use of any funds awarded, whether there are financial controls to ensure the funds are spent for the purposes of the award, and any other matter the Committee considers relevant.²³⁵ The Committee can also have regard to the extent to which the issues to be litigated in the class suit affect the public interest, the likelihood that the proceeding will be 'certified' by the court²³⁶ and the amount of money in the Fund that has been allocated to provide financial support in respect of other applications.²³⁷

If the representative plaintiff financially supported by the Committee is successful, the amount advanced to the plaintiff from the Fund plus ten per cent of the settlement funds or monetary award is to be paid to the Fund.²³⁸

The SALRC's Proposal

The SALRC recommended the creation of a Class Action Indemnity Fund which would 'perform' the following functions:

- (a) the provision of a legal aid scheme (limited to class actions) for proposed representative plaintiffs who are unable to obtain legal representation to institute and prosecute a class action without incurring personal liability for costs;
- (b) provision in proper cases for the payment of the costs of defendants . . .
- (c) the alleviation of any hardship caused to class members by defaults or defalcations of a representative or his agents.²³⁹

²³⁴ G D Watson, 'Ontario's New Class Proceedings Legislation — An Analysis' in G D Watson and M McGowan, *Guide to Case Management and Class Proceedings* (1995) 1, 7. See also J J Carthy, W A D Millar and J G Cowan, *The Ontario Annual Practice 1993-94* (1994) CP-2 ('The Law Foundation will have to be very circumspect in considering even a modest initial outlay for an expert witness, having knowledge that it is accepting the potential of a huge award of costs in favour of a defendant').

²³⁵ *Law Society Act* 1990, s 59.2(4). For a discussion of these criteria see *Edwards v Law Society of Upper Canada* (decision of the Class Proceedings Committee; 25 April 1995).

²³⁶ This requirement only applies, of course, if the application for financial support is made before the proceeding is certified as a class proceeding.

²³⁷ O Reg 771/92, cl 5.

²³⁸ O Reg 771/92, cl 10(3). 'During 1993 two applications for funding were received by the Class Proceedings Committee, both of which were in the first stage of the proceedings. . . . One of the applications was denied funding by the Committee and the other was outstanding at December 31, 1993, with no decision having been made by the Committee. No awards were made by the Committee and no money was paid from the Class Proceedings Fund to applicants': The Law Foundation of Ontario, *1993 Annual Report*, 3.

²³⁹ Section 10(7)(ii) of the 'Draft Bill For A Class Actions Act' in SALRC Report, op cit (fn 204) 16.

The SALRC envisaged that the money for its proposed Fund would come from the unclaimed residue of damages awarded in favour of class suits.²⁴⁰

The ALRC's Proposed Fund

The ALRC proposed the creation of a special fund to provide for the costs of parties involved in grouped proceedings.²⁴¹ This fund would apply a merit test to any application for financial assistance. The ALRC was of the view that 'while there may be special cases where means should be taken into account, the focus of any special fund should be to provide funding based on merit'.²⁴² This fund would be used to 'provide support for the applicants' proceedings and to meet the costs of the respondent if the action is unsuccessful'.²⁴³

Critique of Special Funds For Class Actions

The ALRC explained the need for a special fund to provide financial assistance to representative plaintiffs as follows:

The grouped procedure is designed to provide access to legal remedies for people who might not otherwise be able to pursue their rights because of cost and other barriers. In the case of individually non-recoverable claims, a special fund available to provide support for the applicants' proceedings and to meet the costs of the respondent if the action is unsuccessful would assist people to obtain a legal remedy and would remove the risk of paying party-party costs if the action failed. . . . In individually recoverable cases the fund could be used to assist with the additional costs which the principal applicant might otherwise have to bear thus promoting judicial economy by encouraging the grouping of these proceedings. Public funding would be an acknowledgment that there is a public purpose to be served by enhancing access to remedies where this is cost effective, especially where many people have been affected.²⁴⁴

Similar reasoning was behind the SALRC's proposal,²⁴⁵ the special funds created in Quebec²⁴⁶ and Ontario,²⁴⁷ and the recent proposal of the AJAC to 'establish a fund to provide assistance for test cases in the interests of disadvantaged groups and for large scale civil litigation involving many parties in different jurisdictions'.²⁴⁸

²⁴⁰ 'It is suggested that the Attorney-General should be served with a copy of the application to dispose of any undistributed balance in Court': id 10.

²⁴¹ Grouped Proceedings, op cit (fn 5) para 309.

²⁴² Id para 310.

²⁴³ Id para 308.

²⁴⁴ Ibid.

²⁴⁵ SALRC Report, op cit (fn 204) 10.

²⁴⁶ 'Because class actions could benefit many injured persons, it was believed to be appropriate for the state to assume the financial burden that otherwise would be cast on a representative plaintiff': Ontario Report, op cit (fn 1) 694.

²⁴⁷ See The Law Society of Upper Canada, *Class Proceedings: Guidelines for Practitioners* (1993) 5; Advisory Committee, op cit (fn 224) 60.

²⁴⁸ Action Plan, op cit (fn 152) para 9.83. In response to the AJAC's recommendation, the Commonwealth government has recently indicated that it 'will provide earmarked funding of \$2.9 million over the next four years to assist people to run cases of national importance in previously untested areas of the law, where clarification of the law will benefit the community': Justice Statement, op cit (fn 212) 108.

The notion of public financing of class actions was rejected by the OLRC on both philosophical and practical grounds. The major supporting argument put forward by the OLRC in relation to the 'philosophical' rejection of public funding was as follows:

In chapter 6 . . . we rejected a 'public' class action model, which would involve the Attorney General for Ontario in the initiation and prosecution of class litigation; it was our firm view that the class action procedure should depend on private initiative. Consistent with this position, we believe that the financial responsibility for the conduct of class litigation similarly should be assumed by private citizens, rather than by the Ontario government.²⁴⁹

The unpersuasive nature of the reasoning above becomes evident when one considers that the arguments which were embraced by the OLRC in order to reject a public class action model were mainly of a pragmatic nature rather than of a conceptual nature²⁵⁰ and that the OLRC appeared to concede the validity of the argument that class suits possess a public character or dimension.²⁵¹

The second argument relied upon by the OLRC was that 'any attempt to implement such a proposal would entail considerable expenditure of time and money in the organization and maintenance of an administrative structure that is capable of managing the fund and regulating access to it'.²⁵² While the accuracy of this assessment cannot be challenged, these practical disadvantages must be balanced against the desirable results that are attained by allowing public funds to remove some of the considerable obstacles that currently deter many potential class representatives from taking legal action on behalf of a class. The considerable financial and administrative burdens entailed in the establishment of a class action fund represent a small price to pay for the highly desirable policy goal of increased access to justice. Consequently, it is submitted that a public fund should be set up to provide financial assistance to representative plaintiffs in relation to both disbursements and the class lawyer's fees. The predominant eligibility criteria for financial assistance should be the merits of the applicant's case.²⁵³ The interrelation between contingency fee agreements and a public fund for class actions was described as follows by the ALRC:

In short the availability of fee agreements provides a private means of paying for grouped proceedings as an alternative to financing by the fund. This

²⁴⁹ Ontario Report, *op cit* (fn 1) 713. See also J S Emerson, 'Class Actions' (1989) 19 VUWLR 183, 207 ('the use of the state to support actions in these circumstances involves an extensive free-rider effect at the cost of the taxpayer, and would also act as an incentive for classes to pursue unmeritorious claims').

²⁵⁰ Ontario Report, *op cit* (fn 1) 293-7.

²⁵¹ *Id* 712.

²⁵² *Id* 713.

²⁵³ As was noted by the ALRC, 'it would not be appropriate to apply the usual means test to the applicant in view of the fact that he or she would be conducting proceedings for many other people and the costs incurred are likely to be significantly higher than the costs of an individual proceeding': Grouped Proceedings, *op cit* (fn 5) para 310. A merit test will address the concern of Emerson (see fn 249 *supra*) of unfounded 'class claims'.

gives a principal applicant freedom of choice and relieves pressure on the public purse.²⁵⁴

A major source of finance for class action funds in Ontario and Quebec, and in the proposals of the ALRC and the SALRC, is constituted by costs orders in favour of the financially assisted class representative. As a result of the recommendation contained in Part IV above, that the American rule should be used in relation to class actions brought under the Act, this source of funds will not be available under the author's proposed scheme. Alternative sources of finance for the fund must therefore be found. One possible source would entail requiring that a small percentage, such as four per cent, of the settlement or judgment obtained by the 'assisted' class suit be paid into the fund, in addition, of course, to the amount of the grant.²⁵⁵ Another acceptable possibility involves the transfer into the fund of any unclaimed residue of damages awarded in favour of class suits, whether or not these classes have had the benefit of public financing.²⁵⁶ A third option involves seeking small contributions from the assisted class plaintiffs.

This special fund will play a crucial role in representative proceedings seeking non-monetary relief. As was demonstrated in Parts II and III, in most cases contingency fee arrangements and contributions from class members can provide assistance to class representatives only in suits seeking monetary compensation.

VI CONCLUSION

In writing this article, the author has been guided by two fundamental principles:

First, . . . the costs disincentives attributable to the fact that the action is proceeding in class, rather than in individual, form should be removed. Secondly . . . we should strive to effect changes involving the least possible disruption to the principle of equality of treatment of parties that underlies the existing . . . costs rules. Whatever costs rules are to be implemented should be fair to all participants in class litigation.²⁵⁷

The application of this conceptual framework has resulted in the formulation of a number of recommendations which may be summarised as follows:

- (1) the extensive use of the mechanism created under s 33ZJ(2) pursuant to which the costs incurred by the representative plaintiff in conducting the litigation on behalf of the class can be deducted from the settlement

²⁵⁴ Grouped Proceedings, *op cit* (fn 5) para 314.

²⁵⁵ This is a feature of the public financing regimes in Ontario and Quebec.

²⁵⁶ 'A . . . possible disposition is for the unclaimed portion of the fund to escheat to the state under the principles applied to unclaimed property. The escheat of unclaimed damages remaining in the court is justified under both legal and equitable principles. It also affords a solution that can be applied simply': A R Golbey, 'Attorney's Fees, Unclaimed Funds, and Class Actions: Application of the Common Fund Doctrine' (1979) 48 *Fordham Law Review* 370, 391.

²⁵⁷ Ontario Report, *op cit* (fn 1) 703.

or judgment obtained in favour of the class before distribution of this 'fund' to the class members takes place.

- (2) The introduction of contingency fee arrangements pursuant to which the lawyer acting on behalf of the class will be paid a higher than normal fee in the event of victory by the 'class' but will receive no remuneration in the case of victory by the respondent. These contingency fee arrangements should be permitted to include all disbursements. The fees of the class lawyer and any 'settlement' of the claims of the class will need to be approved by the judge presiding over the class suit.
- (3) The replacement of the costs indemnity rule with the American rule.
- (4) The creation of a special fund to assist class plaintiffs in the payment of disbursements and the fees of the class lawyer.

The likely effect of the author's proposed costs regime for class actions will now be considered in relation to class suits seeking monetary compensation as well as suits litigating over injunctive or other non-monetary relief.

Class actions seeking monetary relief

In relation to claims that have a reasonable chance of success, the representative plaintiff should be able to obtain a grant from the Class Action Fund or to find lawyers who are willing to act on behalf of the class on a no win-no fee basis.

The costs borne by the class lawyer, or by the Class Action Fund, will be deducted from the settlement or judgment obtained by the class before distribution of the 'fruits' of the litigation takes place.

Class actions seeking injunctive or declaratory relief

Contingency fee agreements may be entered into if the representative plaintiff is able to obtain financial assistance from class members or others to meet the class lawyer's higher than normal fee following the successful outcome of the class suit.

In most cases, however, the most realistic alternative is to apply to the Class Action Fund for financial assistance. If financial assistance is received from the Class Action Fund, the liability of the class representative is limited to the making of a contribution to the Fund, as the financial burdens of the class suit will be borne entirely by the Fund.