MEMORANDUM #3

To:	The MOJ/CJC Damages-based Agreements Working Group
From:	Rachael Mulheron
Date:	1 July 2012
Re:	Contingency fees and collective actions

Dear Colleagues,

As mentioned in the note of 'preliminary thoughts from the chairman for first meeting on 17 April', one of the questions which the WP will need to address (per item 9) is:

> **'Will special consideration need to be given to contingency fees in Group Actions, e.g., approval of the percentage fee by the court?'**

Below is a summary of the key issues which may arise, if contingency fees are used (or are sought to be used) in conjunction with collective actions.

Please note that this does **not** purport to be a comprehensive up-to-date research exercise of Ontario case law in which all relevant issues to do with contingency fees in class actions are canvassed (time pressures have precluded such an undertaking). However, some of the issues below have certainly arisen in the costs-shifting class actions landscape of Ontario, and hence, may be of interest, both now, and in the future, for those law-makers who are tasked with implementing DBAs, and/or collective actions, into English law,

Best wishes

Rachael

Prof. Rachael Mulheron
Department of Law
Queen Mary University of London
r.p.mulheron@qmul.ac.uk

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THE LEGAL ISSUES BRIEFLY RAISED IN THIS REPORT

1. **Whether there should be any carve-outs of areas of collective redress litigation in which DBAs cannot be used**

2. **Even if percentage contingency fees (DBAs) are not specifically countenanced for group/class actions, could they be judicially permitted anyway?**

3. **Should there be a cap on the amount of contingency fee permitted in collective actions?**

4. **Should a sliding scale of contingency fee be permissible, in group/class actions?**

5. **Whether the Ontario model or the Success Fee model should**

6. **Should the fee agreement be approved by the court?**

7. **Avoidance of 'tied classes'**

8. **An order of costs against the representative claimant**

9. **An order of costs against the representative claimant's lawyers**

1. Whether there should be any carve-outs of areas of collective redress litigation in which DBAs cannot be used

In the Government's recent consultation on reform of the regime for private actions in competition law in the UK, Department of Business, Innovation and Skills, '*Private Actions in Competition Law: A Consultation on Options for Reform*, the Government expressed concern in relation to contingency fees for opt-out collective damages actions, and suggested (in Box 6, at p 35 of the Consultation) that **no** contingency fees should be available for the proposed collective action regime.

No carve-outs of DBA availability have been specified in s 45 of the LASPO Act 2012. Should sectoral legislation be permitted to do that instead?

Lord Justice Jackson expressly acknowledged, in his Final Report, that so far as **collective actions** were concerned (at ch 33, [4.5]):

> If the recommendations set out in chapter 12 above are accepted, it will be legitimate for both solicitors and counsel to conduct litigation on a contingent fees basis. This method of funding may be appropriate for group action where (a) the lawyers have sufficient confidence in success, and (b) the claimants receive independent advice that the terms of the proposed contingency fee agreement are reasonable.

Hence, it was clearly the intention of the author of the costs reform envisaged by the LASPO Act that collective redress **would** be able to take advantage of the funding mechanism of contingency fees. No carve-outs or exceptions to that scenario were envisaged by Lord Justice Jackson. As stated, nor have any been suggested in the LASPO Act 2012 itself.

2. Even if percentage contingency fees (DBAs) are not specifically countenanced for group/class actions, could they be judicially permitted anyway?

There is an uneasy precedent in Ontario, whereby the legislature in that jurisdiction provided for a multiplier method of contingency fee in Ontario's Class Proceedings Act 1992 (per s 33(3)) — and, yet, the courts decided to bypass that method, and permit percentage contingency fees.

If England wishes to ban DBAs for group/class actions in England, then the legislature may have to state that explicitly, to avoid the Ontario situation, which can be described as follows (per R Mulheron, *The Class Action in Common Law Legal Systems: A Comparative Perspective* (Hart Publishing, 2004) p 475 (footnotes omitted):

> Due to the fact that the Ontario statute [the Class Proceedings Act 1992] makes no reference to permitting contingency fees based on a percentage-of-recovery, but specifically refers to another form of contingency agreement, it had been understandably and generally assumed by academic commentary, earlier in the life of the statute (and in line with the Ontario Law Reform Commission's recommendations) that such contingency fees were not permitted in class actions in Ontario. However, that proved to be incorrect. Percentage contingency fee agreements were permitted in 1996 [in *Nantais v Telectronics Pty (Canada) Ltd* (1996), 134 DLR (4th) 470], and have since been judicially endorsed on the basis that they promote efficiency in the litigation and discourage unnecessary work that might otherwise be done by the lawyer, simply in order to

increase the base fee. Also in line with US case law, recoveries of up to 30 per cent have been approved in Ontario.

It is probably worthwhile for England's legislature to avoid the uncertainty that emerged in Ontario, regarding whether or not percentage contingency fees were permitted in class actions litigation, where they were not specified to disapply.

3. Should there be a cap on the amount of contingency fee permitted in collective actions?

If aggregate assessment of the class's damages is permitted in any context (as proposed by the BIS Consultation Document, for an opt-out collective action for competition law claims), would a cap on the percentage contingency fee be appropriate — even if the claims the subject of the class litigation did not comprise personal injury?

Aggregate assessment of damages could be very considerable in such cases. It may placate the Government's nervousness about contingency fees in opt-out class action, if a cap is set in such cases.

Furthermore, the Government (via BIS) is concerned that a contingency fee may incentivise lawyers to artificially inflate the number of claimants in class/group actions. This concern is misplaced in the case of opt-out class actions, because if the claim is brought on an opt-out basis, the number of claimants in the class bringing the claim will be constant, and not capable of inflation by the claimant's lawyers. Since the class definition will need to be certified, the number of claimants in the class is outside the control of the claimants' lawyers. However, in the case of opt-in group actions, theoretically, there would be an incentive to inflate the number of claimants in the group. However, individual class members will have to prove their entitlement to damages — and assuming that they can do so, then a cap on the contingency fee possible to recover, per group member, would presumably ease the concern about artificial inflation of group numbers.

4. Should a sliding scale of contingency fee be permissible, in group/class actions?

It is common in class actions jurisprudence in other jurisdictions, that a class lawyer will be paid a percentage of the quantum of damages recovered by the class, but on a scale varying according to when the class action is resolved (e.g., 20% of recovery if settlement is reached within a certain period; 25% if settled prior to trial; 30% if the matter proceeds to a trial).

Hence, if a cap on the percentage contingency fee is to be set in English law for group/class actions, should it be subject to a sliding scale of the type described above, or not?

5. Whether the Ontario model or the Success Fee model should apply?

The difficulties of whether the class lawyers can recover the contingency fee + recoverable inter partes costs (per the Success Fee model); or only the contingency fee, including inter partes costs (per the Ontario model)—dealt with separately in Memoranda #1 and #2—will be crucially important in group/class actions. The inter partes costs recoverable from the defendant will, in most cases, be considerable, in group/class actions.

If the class lawyer can only claim the balance of the contingency fee from the client, per the Ontario model, it could make the class action infeasible to pursue , if there is a cap in place. This uncertainty, as to whether English law will embrace the Success Fee model, or the Ontario model, needs to be clarified, for group/class actions.

Significantly, Ontario does **not** impose a cap on contingency fees in class actions conducted in that jurisdiction.

6. Should the fee agreement be approved by the court?

It has been recognised, in the Canadian provincial class actions jurisdictions, that there needs to be some judicial control of contingency fee arrangements/DBAs in collective actions, to protect the interests not only of defendants but also—and perhaps more importantly—of the represented claimants who do not actively participate in the case and who are not personally before the court.

In those Canadian jurisdictions, the court must approve the reasonableness of the fees of the class lawyers, before any distribution of a damages award to class members can be made.

In that regard, it is useful to point to the draft court rules which were drafted in anticipation of the Financial Services Bill 2010 becoming law, which contained an opt-out class action regime for 'financial services claims' (see '*Draft Rules for Collective Proceedings*', available on the Civil Justice Council website, under 'European Consultations', 'Collective Redress'). Draft CPR 19.42 provided, in part, that:

> An agreement in relation to the fees and disbursements payable by the class representative in respect of the collective proceedings must be in writing, and must (a) state the terms under which fees and disbursements are to be paid; (b) give an estimate of the expected fee, and state whether or not that fee is conditional on success in the collective proceedings, and (c) state the method by which payment is to be made, whether by lump sum or otherwise.
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> An agreement in respect of fees and disbursements payable by the class representative is not enforceable unless approved by the court.

This requirement is surely very laudable, for the protection of defendant and absent class members alike, and should be implemented for any newly-introduced opt-out collective actions regime for England.

Indeed, the fact that fee agreements between class lawyer and representative claimant were not required to be judicially approved, under the explicit wording of Australia's class actions regime, has come in for severe criticism, both judicially and academically (as discussed in Mulheron, *The Class Action*, supra, pp 477–79). England's rule-makers have seen fit to learn from that adverse experience, as highlighted by the provision in draft CPR 19.42, above.

7. Avoidance of 'tied classes'

Certain issues have arisen under the Australian opt-out class action which are potentially relevant to the English landscape, should it introduce an opt-out class actions regime,

Law firms in Australia have sometimes required a 'tied class' of individual class/group members,

so that an opt-out model essentially converts to an opt-in model. Class members may be under an obligation to take a positive step to join the class — by proactively entering into a client retainer with the law firm which has the conduct of the matter — because, from the outset, the class definition is worded so as to impose that 'tie'. The point has become a hotly-contested issue in Australian class actions jurisprudence.

Unless the English legislature provides that the lawyers representing the class (under an opt-out regime) can claim their contingency fee as a *first charge* upon any aggregate assessment of damages imposed by the court, the law firm representing the class may wish to ensure that there is a contractual basis for recovery of those damages, by entering into a contract with each class member. There is the prospect that, without that contractual provision, the representative claimant may have no entitlement at common law to enter into an agreement with a law firm, which authorises that law firm to recover its contingency (success) fee from the damages payable to the class/group members, other than the representative claimant. To achieve that result, the law firm must enter into contractual agreements to that effect with the class members, as well as with the representative claimant.

To convert an opt-out regime to an opt-in regime, prior to the commencement of the class action, may be viewed as being 'against the spirit' of an opt-out regime (as some Australian judges have viewed the matter – discussed, e.g., in R Mulheron, 'Opting In, Opting Out, and Closing the Class: Some Dilemmas for England's Class Action Law-makers' (2011) 50 *Canadian Business LJ* 335, 359–62.

This problem only arises with respect to an opt-out class actions regime, but it may be worth raising, in the present context of Working Group consideration of contingency fee agreements.

8. An order of costs against the representative claimant

Given that, regardless of how a collective action is funded, the conventional costs-shifting rule will continue to apply, that immediately gives rise to three conundrums:

- ❑ to what extent should the representative claimant's financial wherewithal to meet an adverse costs order (whether from his own resources or from other external sources) form part of the 'adequate representative' certification criterion, in an English collective actions regime?

- ❑ when, if ever, should costs not shift to a losing representative claimant to bear? That is, when (and why) should a defendant, who as successfully defended a collective action or certification motion, not be entitled to take advantage of the usual costs-shifting rule?

- ❑ precisely when (and why) should security for costs be awarded against the representative claimant?

Each of these issues has assumed huge significance in Ontario (and, to a lesser extent, Australian) class actions jurisprudence, and a comprehensive study of the answers to these questions, in light of relevant case law, was undertaken in: Mulheron, 'Costs Shifting, Security for Costs, and Class Actions: Lessons from Elsewhere' in D Dwyer (ed), *The Civil Procedure Rules Ten Years On* (OUP, 2009) ch 10. Some of that jurisprudence may be of interest and relevance, should a formalised collective action be introduced into English civil procedure in the future.

In that regard, it is notable that, when a set of draft court rules were developed for the proposed class action foreshadowed by the Financial Services Bill 2010, the capacity for security for costs against a

representative claimant was expressly preserved, if it became apparent (at or after the time that the collective action was certified) that the representative claimant was not likely to be able to meet any costs order which may be made against that party. (Please refer to: draft rule CPR 25.13(2)(h) of the '*Draft Rules for Collective Proceedings*' (available on the Civil Justice Council website, under 'European Consultations', 'Collective Redress'), which provided the insertion of the following, in CPR Pt 25, 'Security for Costs':

> the claimant has been authorised to act as the class representative in collective proceedings under rule 19.19 and there is reason to believe that the claimant will be unable to pay the defendant's costs if ordered to do so.

Notably, draft rule CPR 19.21(2)(b)(iv) of the *Draft Rules for Collective Proceedings* also provided an explicit certification criterion of financial adequacy of the representative claimant.

9. An order of costs against the representative claimant's lawyers

As mentioned in **Memorandum #1**, under 'Issue #3', class action lawyers in Ontario typically enter into an agreement with their clients, by which they agree to indemnify the representative claimant against adverse costs orders, should the representative claimant lose on the common issues.

Sometimes such an indemnity is not given (or not given in a timely or clear manner), which raises the question as to whether the court may order costs against the class lawyers in any event, as a non-party.

This issue arose, e.g., in *Poulin v Ford Motor Co of Canada* [2007] Canlii 56490 (ONSC), in which Mr Poulin failed in his attempt to have a class action certified. He had been represented by both Canadian counsel and by US co-counsel.

The position of the Ford defendants was that both sets of lawyers should be jointly and severally liable to pay the defendant's party and party costs, on a substantial indemnity basis, because they were the 'entities which created the litigation and had the most to gain financially should bear the burden of a costs order. In many respects, Mr Poulin was recruited to be merely a name on a pleading as opposed to an aggrieved person seeking a remedy from the Court'. At the time of the certification motion, no indemnity had been given by either counsel to Mr Poulin in respect of adverse costs, although the Canadian lawyers did make that undertaking during submissions as to costs.

The court agreed that there was a power to order costs against class counsel directly. That was by virtue of: s131 of the Courts of Justice Act, which established that the court did have authority to award costs against non-parties (and affirmed in: *Smith v Canadian Tire Acceptance Ltd* (1995), 22 OR (3d) 433 (Gen Div), aff'd: (1995), 26 OR (3d) 94 (CA). Also, the court had jurisdiction to award costs against solicitors where that solicitor has initiated a proceeding without authority, i.e. informed instructions from the client, pursuant to r 15.02(4) of the Rules of Civil Procedure, and pursuant to the court's inherent jurisdiction to control its own process (per *Young v Young* [1993] 4 SCR 3, 135--36).

Ultimately, costs orders against the class lawyers **were** made. The US lawyers had claimed that no such order was possible, given that they were non-residents of Ontario, but that was rejected by the court. It held that the fact of non-residency was not an impediment to the court's jurisdiction to award costs, and that the Ontario court did have jurisdiction to make an award of costs against the US law firm, as a non-resident non-party. The court said (at [46]): 'In sum, the position taken by Costs Counsel on behalf of Motley, Rice seeking to deny the jurisdiction of this court with respect to adverse costs consequences is

inconsistent and self-contradictory with the position that would have been taken had the certification motion been successful, i.e. seeking fees in their capacity as co-counsel to Mr. Poulin.'

Ultimately, a costs order against the Canadian class action lawyers was made too. MacKenzie J justified that conclusion, not on the basis that the action was issued without authority, but for these reasons (at [69]–[71]):

> *it is appropriate in all the circumstances of this case to examine the role of Will Barristers in the initiation and prosecution of the action. Although they are described as co-counsel with Motley, Rice, Will Barristers did not provide the catalyst for the initiation and prosecution of the action. However, it is unnecessary to determine whether Will Barristers or Motley, Rice was the true quarterback in the action: any command and control functions exercised by Will Barristers in the action were ancillary to Motley, Rice's role as the underwriter of the litigation. It is nonetheless incontrovertible that Will Barristers were an integral and significant part of the team.*
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> *An examination of the financial aspects arising out of the co-counsel agreement definitively establishes that Will Barristers and Motley, Rice were splitting any fees derived from the successful outcome of the action (by judgment or settlement) after reimbursement of all litigation expenses incurred by Motley, Rice: paragraph 89, Endorsement. I repeat, at the time of the Certification Motion, there was no indemnity undertaking on behalf of Will Barristers in favour of Mr. Poulin although there is no evidence that the latter was impecunious or a 'man of straw'. The fact remains that at the time of instituting the action and mounting the Certification Motion, Mr. Poulin was without an indemnity undertaking and it was accordingly, open for Will Barristers and Motley, Rice to obtain extremely large fees arising from a successful outcome without any concomitant risk of adverse costs consequences.*
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> *For the above reasons, I conclude that Will Barristers is subject to a costs award in favour of the defendants arising out of the Certification Motion.*

It was acknowledged that these costs orders were being made in the context of an 'exceptional case' (at [81]).

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