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Australian Federal Court Reforms Class Actions Settlement Practice

A number of Federal Court of Australia judgments in the first half of 2018 have adopted or raised reforms to the mandatory approval process for class action settlements. The reforms mean that the class action settlement process is in a state of flux. While predominantly a concern for applicants, their lawyers, and funders, the process also impacts respondents who are seeking finality and wish to avoid the uncertainty and cost of settlements being refused or challenged.

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Four recent decisions of the Federal Court of Australia have adopted or raised law reforms that are resulting in significant changes to the mandatory approval process for class action settlements required under Part IVA of the *Federal Court of Australia Act 1976* (Cth) (“FCAA”). The reform topics are as follows:

- The application of the overarching purpose in the FCAA, which includes concerns about efficiency, to the powers under the class actions regime in Part IVA;
- The court’s assessment of legal costs, in particular how they may be assisted by the appointment of an independent referee, rather than a costs expert retained by the applicant’s lawyers;
- The appropriateness of appointing the applicant’s lawyers as administrators of a settlement distribution scheme;
- The basis upon which payments may be made to applicants in addition to the compensation they receive as group members; and
- The court’s power to vary a funding agreement while simultaneously approving a settlement.

BACKGROUND

Pursuant to s 33V of the FCAA, Australian class action settlements must be approved by the court. The approval process considers whether the settlement is fair and reasonable, including the payment of legal fees and litigation funding fees. The conduct of Australian class action settlements has attracted critique from commentators¹ and is the subject of review by the Victorian Law Reform Commission and Australian Law Reform Commission. The Federal Court has also actively sought to engage with the concerns raised about the settlement process. In particular, four recent decisions have adopted or recommended reforms that substantially change the class action settlement process: *Lifepan Australia Friendly Society Limited v S&P Global Inc* [2018] FCA 379 (“*Lifepan*”); *Dillon v RBS Group (Australia) Pty Limited (No 2)* [2018] FCA 395 (“*Dillion*”); *Clarke v Sandhurst Trustees Limited (No 2)* [2018] FCA 511 (“*Clarke*”); *Caason Investments Pty Limited v Cao (No 2)* [2018] FCA 527 (“*Caason*”).²

CASE MANAGEMENT

The Federal Court of Australia’s enabling legislation contains an overarching purpose (s 37M(1)), which is to facilitate the just

resolution of disputes: (i) according to law; and (ii) as quickly, inexpensively, and efficiently as possible. The court is required to interpret and apply civil practice and procedure provisions, including the class actions regime, in a manner that best promotes the overarching purpose.

Justice Lee in *Lifepan* opined that the role of the overarching purpose had received minimal attention from Australian courts in settlement approval applications, but noted that an objective of the settlement approval process was to achieve consistency with the overarching purpose provision. That is to say, a settlement distribution scheme must facilitate the distribution of the settlement sum in a way that maximises efficiency and minimises cost to group members.³ This comment is significant, as arguments regarding economic efficiency are not regularly made in s 33V applications.

In *Caason*, Murphy J found several practices of the applicants’ lawyers were inconsistent with s 37M. First, an excessive amount of evidence was filed that was not referred to at trial. This evidence needs to be reviewed by the court and the parties. Justice Murphy noted that if parties continued this trend in the future that “there are likely to be consequences”.⁴ His Honour did not go further, although it may be assumed that such consequences may see lawyers bear their own costs for the production of superfluous evidence. Section 37M again arose in respect of a clause of the settlement agreement that stipulated that the settlement would have no effect unless the court made a common fund order. In Australia, common fund orders provide for the litigation funder to recover a court-specified fee from all group members, regardless of whether the group member entered into a funding agreement. Although a common fund order was ultimately made, his Honour found that this clause left open the possibility that a court might hear and decide a settlement approval application, only for that agreement to be rendered null, which would in turn lead to the waste of court resources.⁵

COST ASSESSMENT

It has traditionally been common practice for practitioners to provide an affidavit from an independent costs expert who assesses the reasonableness of the legal costs and disbursements incurred as part of seeking court approval of legal fees.

Justice Lee in *Lifeplan* did not approve of the traditional practice; remarking that such evidence was “next to useless” and that he had yet to see a costs assessor form the independent view that the solicitor who retained them had charged unreasonable fees.⁶ Seconding Lee J’s concerns, Murphy J in *Caason* noted that there was “a question as to whether costs experts routinely engaged by solicitors that act for the applicants in class actions are truly independent, and whether they are likely to suffer from bias such as to be “tame” experts”.⁷ Justice Murphy also noted that the possibility of expert witness bias is amplified when an independent costs expert provides an opinion on a s 33V application because (i) the law firm is essentially pursuing its own interests in seeking that costs be approved, (ii) there is no opposing expert report, and (iii) there is usually no contradictor.⁸ His Honour considered the use of court officers and registrars, and noted that while it was a valid option, it would be an ultimately unsustainable practice, and that the appointment of an independent referee may be preferable.⁹ Orders were then made under s 54A of the FCAA to appoint an independent referee to assess the applicants’ costs.¹⁰ His Honour speculated that it may be apposite for the court to create “a panel of competent and reputable independent costs consultants” in order to reduce “the reasons for conscious or unconscious bias” in the future.¹¹

In *Dillon*, pursuant to a court order, a referral out to an independent referee was made for the inquiry and reporting of whether the legal fees incurred were fair and reasonable. The referee reported that the claimed costs of the proceeding were fair and reasonable, but the proposed administration costs were too high. Lee J adopted the report and commented:¹²

the reference process is a very considerable improvement on the self-serving process of applicants engaging cost consultants to provide expert opinion evidence as to the reasonableness of costs (a practice which, in my view, is less than satisfactory and should be consigned to the dustbin of procedural history).

However, in *Clarke*, it was originally proposed that an independent referee would be appointed to assess the applicants’ legal fees, but the step was not taken due to concerns that the cost of the reference process would outweigh any benefit in the augmentation of the amounts paid to group members.¹³ Lee J simply approved the legal costs in that case.

The assessment of legal costs is improved through the use of an independent, court-appointed referee, but at present the practice is still uncertain.

SETTLEMENT ADMINISTRATION

In *Lifeplan*, Justice Lee appointed the applicants’ lawyers as administrators of the settlement distribution scheme, but went on to note that practitioners should cease expecting that courts will appoint solicitors as scheme administrators.¹⁴ Instead, it may be appropriate in future matters to appoint a service provider who charges a lower rate for remuneration.¹⁵ However, his Honour was ready to appoint the applicants’ solicitors as administrators in this case due to the small size of the group and the efficiency with which the applicants had thus far acted.¹⁶ Nonetheless, practitioners wishing to act as administrators may find they are subject to greater scrutiny and may need to adduce evidence showing why their appointment will be cost-effective.

The settlement agreement in *Caason* appointed a partner of the applicants’ law firm as administrator of the settlement distribution scheme. Justice Murphy sought to ensure greater oversight and accountability of the administrator by requiring the administrator to provide reports to the court as to the progress and costs of the settlement administration.¹⁷ Further, if any requirement under the scheme was not complied with within 14 days of the due date, then the administrator had to notify the court of the occurrence and provide an explanation as well as an estimate as to when the requirement would be met and why that amount of time would be necessary.¹⁸ Murphy J’s approach is consistent with the Federal Court’s Class Actions Practice Note that, since its reissue on 25 October 2016, requires that the court be advised at regular intervals of the progress of a SDS to ensure “that distribution of settlement monies to the applicant and class members occurs as efficiently and expeditiously as practicable”.¹⁹

REIMBURSEMENT PAYMENTS FOR APPLICANTS

It has become standard practice for applicants to seek, and a court to award, a payment to compensate an applicant for the time the applicant has spent representing group members.

However, in two of the recent cases the basis for reimbursement has changed.

The applicants in *Lifeplan* sought an additional \$250,000 in addition to their recovery as group members to compensate them for funding the litigation. Previously, reimbursement has not been awarded on the basis of an applicant having funded the litigation.²⁰ Lee J permitted the payment, which marked an expansion of the basis upon which such payments may be made, although his Honour went on to say that he did not reach this conclusion without misgivings and that his acquiescence on this issue should not be taken as precedent for future cases.²¹

The applicants in *Dillon* sought \$80,000 in fees, not as a payment to compensate them for their time, but rather as an incentive to act as applicants in the proceedings. While incentivisation payments had not previously been made, the Federal Court in *Farey v National Australia Bank Ltd* [2016] FCA 340 had indicated that such payments may be possible. There was no litigation funder in *Dillon* and, therefore, no protection from an adverse costs order for the applicants if the class action was unsuccessful.²² Consequently, “[g]iven the great risk that was taken by the applicants” Lee J made orders for the payments to be made.²³ However, his Honour noted that if incentivisation payments were to be sought they should be raised with the court at the earliest possible time, typically at commencement.²⁴

The availability of reimbursement and incentivisation payments may be crucial to class actions lawyers and funders being able to attract applicants to commence proceedings. An applicant that is out-of-pocket or exposed to the risk of a large costs awards may be reluctant to take on the role. However, such payments are not without risks. For example, the payment to an applicant beyond the compensation they are able to receive like all other group members, can create a conflict of interest as the applicant may agree to a settlement to obtain the additional fee, rather than acting in the interests of the group.

POWER TO ALTER LITIGATION FUNDER’S FEES

Justice Lee expressed some concern in *Clarke* regarding the difference between the amount of the settlement sum and the amount actually dispersed to group members. In doing so, his

Honour raised the prospect of reducing the amount payable to the funder. His Honour resolved that this was not a necessary course to take, but noted that this might be an area of future reform.²⁵

Previous federal court judgments have addressed this issue, with reliance being placed on FCAA ss 33V(2) (if the court makes an order approving a settlement “it may make such orders as are just with respect to the distribution of any money paid under a settlement”) and 33ZF (“the Court may, of its own motion or on application by a party or a group member, make any order the Court thinks appropriate or necessary to ensure that justice is done in the proceeding”).²⁶ Nonetheless, the existence and scope of the power is not without controversy.²⁷ Indeed in *Clarke* counsel for the litigation funder submitted that the power does not exist. However, a power for the courts to review litigation funding fees undeniably acts as a protection for group members, especially those who lack bargaining power. The issue may require an amendment to the FCAA to clearly grant the court power to review and set a litigation funder’s fee.

CONCLUDING REMARKS

The Federal Court’s willingness to address law reform means that the class action settlement process is in a state of flux. It is crucial that respondents understand the above developments so that they can be factored into class action settlement negotiations and structures.

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ENDNOTES

- 1 See eg. Michael Legg, 'Class Action Settlements in Australia — The Need for Greater Scrutiny' (2014) 38(2) *Melbourne University Law Review* 590.
- 2 A notice of appeal has been filed in respect of the *Caason* judgment, which will be heard by the Full Court of the Federal Court of Australia in May 2018.
- 3 *Lifepan Australia Friendly Society Limited v S&P Global Inc* [2018] FCA 379, [33].
- 4 *Caason Investments Pty Limited v Cao (No 2)* [2018] FCA 527, [10].
- 5 *Ibid.*, [37]-[38].
- 6 *Lifepan Australia Friendly Society Limited v S&P Global Inc* [2018] FCA 379, [40].
- 7 *Caason Investments Pty Limited v Cao (No 2)* [2018] FCA 527, [113].
- 8 *Ibid.*, [116].
- 9 *Ibid.*, [117].
- 10 The referee's report was considered inadequate, and provision had to be made for further investigation into the reasonableness of the applicants' lawyers costs.
- 11 *Caason Investments Pty Limited v Cao (No 2)* [2018] FCA 527, [123].
- 12 *Dillon v RBS Group (Australia) Pty Limited (No 2)* [2018] FCA 395, [66].
- 13 *Clarke v Sandhurst Trustees Limited (No 2)* [2018] FCA 511, [24].
- 14 *Lifepan Australia Friendly Society Limited v S&P Global Inc* [2018] FCA 379, [54].
- 15 *Ibid.*, [53].
- 16 *Ibid.*
- 17 *Caason Investments Pty Limited v Cao (No 2)* [2018] FCA 527, [104].
- 18 *Ibid.*
- 19 Federal Court of Australia, *Class Actions Practice Note (GPN-CA)*, 25 October 2016, [14.6].
- 20 In *Australian Securities and Investments Commission v Richards* [2013] FCA 89, the Full Court of the Federal Court of Australia overturned an award of a reimbursement award for having funded a class action.
- 21 *Lifepan Australia Friendly Society Limited v S&P Global Inc* [2018] FCA 379, [57].
- 22 The usual costs rule in Australian litigation is that a losing party is liable for the other side's costs. The rule is modified in relation to class actions as the costs rule applies to the representative party only and not to the group members: FCAA s 43(1A).
- 23 *Dillon v RBS Group (Australia) Pty Limited (No 2)* [2018] FCA 395, [74].
- 24 *Ibid.*
- 25 *Clarke v Sandhurst Trustees Limited (No 2)* [2018] FCA 511, [11].
- 26 See *Earglow Pty Ltd v Newcrest Mining Limited* [2016] FCA 1433; *Blairgowrie Trading Ltd v Allco Finance Group Ltd (Receivers & Managers Appointed) (In Liq) (No 3)* [2017] FCA 330, [101]; *Mitic v OZ Minerals Limited (No 2)* [2017] FCA 409, [26]-[32].
- 27 See Justice MBJ Lee, "Varying Funding Agreements and Freedom of Contract: Some Observations", *IMF Bentham Class Actions Research Initiative with UNSW Law Conference: Resolving Class Actions Effectively and Fairly*, 1 June 2017.

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