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CLASS ACTION SETTLEMENT OVERTURNED ON APPEAL FOR FIRST TIME IN AUSTRALIA

The Full Federal Court in *Australian Securities and Investments Commission v Richards* [2013] FCAFC 89 has overturned a 35 percent uplift in recovery for group members who self-financed the cost of prosecuting their class action ("funder's premium"), over those who did not. The uplift was designed to reward the self-financiers in a manner akin to the return an external funder would have taken had one been involved.

The Full Federal Court decision emphasises the important protective role that the courts should play in relation to class action settlements, especially with regard to group members who do not have legal representation. The settlement was overturned as the funder's premium meant the settlement was not "fair and reasonable having regard to the claims made by group members who will be bound by it".

The decision does not foreclose the possibility of group members funding their own class actions, but care will need to be taken to ensure that all group members are treated fairly. The decision may also mean a greater willingness to test the reasonableness of commercial litigation funders' fees as the Full Federal Court found the amount of the uplift was not supported by evidence and the return received by the funding group members was disproportionate to the funds provided.

THE SETTLEMENT

A group of about 1050 members, who on advice from Storm Financial Limited (now in liquidation) borrowed money in the form of margin loans from Macquarie Bank, and then used that money to invest in one or more of nine managed investment schemes, sued Macquarie for their losses. Macquarie paid $82.5 million (or 30.57 percent of the losses claimed) to settle the class action, which required court approval.

As part of the court approval, the applicant sought a funder's premium of 35 percent for those group

members who co-funded the litigation. This meant that group members who contributed to the legal costs and disbursements involved in running the class action recovered 42 percent of their losses, while those who did not contribute only recovered 17.602 percent of their losses. The percentage used was determined by reference to the range of premiums which one sees afforded to third-party litigation funders in respect of class actions. Due to the novel nature of the funder's premium, the Australian Securities and Investment Commission ("ASIC") intervened in the proceedings. Despite ASIC's concerns about the size of the funder's premium and whether adequate notice had been given to group members of the uplift, the Federal Court found the funder's premium to be fair and reasonable.[1]

ASIC appealed the decision on the basis that the internal allocation of the settlement sum as between the funding group members and other group members was not fair and reasonable.

SETTLEMENT DISAPPROVED BY FULL FEDERAL COURT

A unanimous Full Federal Court commenced its judgment by reiterating the important role of the court in approving class action settlements, which it described as "protective", especially in relation to absent group members who are not legally represented.[2]

The court set out a number of reasons for finding that the settlement was not fair and reasonable.[3]

There was an inequality of opportunity to share in the funder's premium. This arose from the solicitors for the applicant not raising the concept until at least two years after proceedings were commenced, and then the specifics of the concept were unclear until the publication of the notice of settlement in March 2013. Further, clients of the solicitor for the applicant were afforded an opportunity to become contributing group members who received a share of the premium by contributing $500 after the settlement had been reached. The opportunity was not provided to group members who were not clients of the solicitor.

The structure of the funder's premium resulted in group members with claims that were relevantly identical being treated differently based on whether they had made a contribution to the costs of the litigation.

The calculation of the premium by reference to the success fees obtained by commercial litigation funders was rejected as a suitable analogy. The group members who funded the litigation did so in the hope that they would receive full reimbursement of their funding contributions but without any expectation that they would receive a premium. In comparison, a commercial litigation funder contributes funds on the basis that they receive a specified proportion of any recovery. These terms are agreed at the commencement of the litigation. There was also insufficient evidence as to why 35 percent was the appropriate premium, other than printouts from websites of commercial litigation funders which seemed to suggest that those funders imposed an uplift of between 25 percent and 45 percent.

The funder's premium was disproportionate. The contributing group members had paid about $5 million in legal fees. The settlement provided for this to be repaid. The funder's premium was in total $28.875 million. The contributing group members received a return on the amount contributed of 525 percent. This was in the context where only the representative party, in this case Mrs Richards, was at risk of an adverse costs order because the class actions regime is structured so that group members are not subject to costs orders should the class action be unsuccessful.[4]

The calculation of the premium was by reference to the claimed equity lost in the underlying action, not the funds advanced for costs. The evidence disclosed that the amount contributed by the funding group members ranged from between as little as $500 up to $31,450, yet all funding group members received the same 35 percent uplift.

RAMIFICATIONS

As the first class action settlement to be appealed and with the Full Federal Court reiterating the important role of the court in the settlement approval process, it is to be

expected that Federal Court class action settlements will be subject to careful judicial oversight. In particular, the Federal Court will want to know how the settlement affects those group members who do not have legal representation.

The proceedings also illustrate the role that ASIC may play through its statutory power to intervene in proceedings. The intervention and the publication of *Information Sheet 180, ASIC's Approach to Involvement in Private Court Proceedings* (June 2013) may indicate that ASIC plans on taking a more active role in monitoring and, where necessary, making its voice heard on important issues of public interest.[5]

The outcome has been described by some as hampering the self-funding of class actions by group members. However, the Full Federal Court stated:[6]

> [the] finding should not be taken as precluding the possibility that group members or a sector of group members might decide from the outset to fund litigation on certain terms and conditions. … The Court accepts that this form of litigation funding is an important alternative to commercial litigation funders and should, to the extent possible, be encouraged. However, from the outset it must be established and managed fairly to those who decide to fund the litigation and those who, for whatever reason, choose not to.

In short, the specific funding regime used in the *Storm* class action was problematic, but that does not mean that a regime for group members to fund their own class action cannot be designed in a manner that would be "fair and reasonable". Greater competition in the litigation funding market therefore remains possible.

The decision may also have ramifications for third-party or commercial litigation funding as well. The fees charged by litigation funders have rarely been examined by the Federal Court when a settlement is approved. However, the Full Federal Court observed that the amount a litigation funder charges is a result of a number of complicated and interconnecting factors, but in the instant case, the evidence adduced to support the imposition of a premium of 35 percent was insufficient. Further, the return on investment received by the funding group members was found to be disproportionate to the funds invested. These observations may suggest a greater willingness to test the reasonableness of a litigation funder's fees more generally. It may also have particular application to those class actions involving funded and unfunded group members where a "funding equalisation factor" is sought. The Federal Court has previously ordered that non-funded group members are to have deducted from their entitlement an amount equal to the commission payable to the litigation funder by the funded group members which is then redistributed across all group members.[7] The Full Federal Court's observations suggest that the percentage employed as part of a "funding equalisation factor" should be the subject of evidence and review.

The litigation funding market in Australia continues to develop as commercial and legal parameters change. *Australian Securities and Investments Commission v Richards* [2013] FCAFC 89 is an important signpost in the legal requirements for the funding of class actions.

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ENDNOTES

1 *Richards v Macquarie Bank Limited (No 4)* [2013] FCA 438. *See also Jones Day Commentary*, "Do-It-Yourself Funding for Class Actions in Australia Takes an Interesting Twist" (June 2013), http://www.jonesday.com/do-it-yourself-funding-for-class-actions-in-australia-takes-an-interesting-twist.

2 *Australian Securities and Investments Commission v Richards* [2013] FCAFC 89 at [8].

3 *Australian Securities and Investments Commission v Richards* [2013] FCAFC 89 at [42]-[52].

4 Section 43(1A) of the *Federal Court of Australia Act 1976* (Cth).

5 *See Jones Day Commentary*, "Guidance on the Interaction Between the Australian Securities and Investments Commission and Class Actions Provided" (July 2013), http://www.jonesday.com/guidance-on-the-interaction-between-the-australian-securities-and-investments-commission-and-class-actions-provided-07-10-2013.

6 *Australian Securities and Investments Commission v Richards* [2013] FCAFC 89 at [53].

7 *Dorajay Pty Ltd v Aristocrat Leisure Ltd* [2009] FCA 19 at [17]; *P Dawson Nominees Pty Ltd v Brookfield Multiplex Ltd (No 4)* [2010] FCA 1029 at [26]-[28].