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GPT CLASS ACTION SETTLEMENT RAISES CONCERNS ABOUT LEGAL AND FUNDING FEES CHARGED IN AUSTRALIAN CLASS ACTIONS

KEY POINTS

- The 7 November 2013 and 21 June 2013 judgments of the Federal Court in the GPT class action settlement[1] signal that the fees charged by law firms to class members will be the subject of greater scrutiny at the settlement stage.
- A possible divergence between the Federal Court and the Victorian Supreme Court may be developing as to the extent to which litigation funders' fees will be permitted to be allocated at the settlement stage to unfunded group members. This may impact where class actions are filed in the future.
- The case signals the possible future adoption by the Federal Court of the US common fund approach to legal fees in class actions.

SUMMARY

The GPT class action was brought by shareholders alleging that GPT Management Holdings Limited and GPT RE Limited (collectively "GPT") had engaged in misleading conduct and breached its continuous disclosure obligations. The class action settled.

On 21 June 2013, the Federal Court approved the settlement sum of $75 million inclusive of interest and legal costs but refused to approve the sum of $9.3 million claimed in respect of the applicant's lawyer's legal fees and disbursements and the sum of $53,530.85 claimed in respect of the applicant/representative party's expenses in prosecuting the claim on its own behalf and that of group members. Both requests for approval were referred to a Registrar of

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the Court to conduct an assessment and report back to the Court. The Registrar reported back, and a further judgment was delivered on 7 November 2013 with $8.5 million awarded for legal fees and disbursements and $10,000 awarded for the applicant/representative party's expenses.

Further, the Court rejected the litigation funder's attempt to recover a percentage fee from group members who had not entered into funding agreements. However, an amount equivalent to the fee was deducted from the non-funded group members' recoveries and redistributed to all group members. Interestingly, the Court had no difficulty in requiring group members who had not entered into a retainer and costs agreement with the lawyers to be required to contribute pro rata to the legal fees once they were approved.

The GPT class action judgments signal the Federal Court's growing interest, and concern, as to how class action recoveries are divided up amongst lawyers, litigation funders, applicants, funded group members and unfunded group members.

APPLICANT'S LAWYER'S LEGAL FEES

Justice Gordon of the Federal Court stated that there were two aspects to the request for the approval of legal fees. The first was that the amount approved by the Court was to be shared on a pro rata basis by all group members irrespective of whether they executed a Legal Costs Agreement ("LCA"). The second aspect concerned the quantum of the professional costs and disbursements incurred by the applicant's lawyers for which the law firm sought approval from the Court.

The first issue deserves comment because the liability to pay legal costs in a class action in Australia was always thought to be the same as for other litigation—there needed to be a contractual obligation to pay. Admittedly, the issue has rarely arisen because the legal costs usually form part of the settlement to be paid by the respondent. Justice Gordon's approach is similar to the common fund approach used in US class actions,[2] although no reference is made to this jurisprudence. Her Honour also suggested that given the increasing number of class actions, perhaps there should be a requirement that any LCA or equivalent between group members and a firm of solicitors should be approved by the Court before it is binding on the group members. This is also a novel approach as the LCA would not normally be binding on group members who are not a party to the LCA.

On the second issue, her Honour expressed concern that the law firm was acting for itself in circumstances where group members were unable to oppose the application and there was no other contradictor before the Court. The group members were unable to oppose the application as they had no notice of the fees and disbursements or how they were quantified.

The applicant's lawyers had engaged a costs consultant to provide an expert opinion on the reasonableness of the legal costs and disbursements incurred. In the judgment Gordon J was highly critical of the law firm and the costs consultant's report and was not satisfied that the report provided the Court with the basis for approving the law practice's fees. Her Honour noted that the amount claimed by the applicant's lawyers was almost three times the original estimate of $3.5 million (which the report failed to explain), that the hourly charge-out rate seemed to have increased by 5 percent with no demonstrated notice of that increase to the members, and the costs for discovery (based on a rate of $550 per hour) seemed unreasonable. The LCA signed by (most of) the group members did not seem to be properly referred to and utilised in the assessment of costs by the consultant.

Gordon J cited *Redfern v Mineral Engineers Pty Ltd* [1987] VR 518 as to the rationale for the court's "surveillance" over costs between solicitor and client and that the solicitor holds a "position of dominance" in circumstances such as these. The distribution scheme provided for the law practice's fees and disbursements to be deducted from the settlement sum prior to the individual group members' entitlements being calculated, which clearly exacerbates such a situation. A conflict of interest arises as the greater the law practice's fees and disbursements, the less compensation that is available for individual group members.

In the second judgment, which considered the Registrar's report, a detailed review of the fees and disbursements disallowed by the Registrar was undertaken, which led to the legal fees being reduced by approximately $800,000. A number of novel issues were also raised by the litigation funder and the applicant's lawyers. The litigation funder, having been granted leave to intervene, submitted that the funder had a role in assessing the reasonableness of the legal fees. Gordon J acknowledged that the funder could be expected to monitor fees but held that the funder could not replace the role of the court, which must assess the fees "in the interests of all group members, not the litigation funder".[3] The applicant's lawyers also submitted that the proportionality of legal fees to the recovery was a useful check on the reasonableness of the fee award sought. Here the fees were 12 percent of the total settlement sum, compared with 16 percent in the Centro class actions. Gordon J rejected this submission.

LITIGATION FUNDER'S FEE

Comprehensive Legal Funding LLC ("CLF") was the litigation funder in the proceedings. Approximately 92 percent of group members (including the applicant, Modtech Engineering Pty Ltd) had executed a Litigation Funding Agreement ("LFA") with CLF to fund the class action. The LFA provided that CLF was to receive a commission of between 25 percent and 30 percent of net recoveries after reimbursement of litigation costs.

The Settlement Distribution Scheme proposed that the funding commission be deducted from the individual entitlements of all group members, including the 8 percent who had not entered into a funding agreement with CLF.

Gordon J rejected this aspect of the scheme as her Honour explained that CLF had made a commercial decision to fund the proceedings by entering into an LFA with just 92 percent of group members. Her Honour stated that the deduction of the funding commission was not a part of the commercial bargain reached by CLF with the 8 percent who had not entered into a funding agreement and that it should not be imposed on those members. Gordon J distinguished *Pathway Investments Pty Ltd v National Australia Bank Ltd* (No 3) [2012] VSC 625, where Pagone J had approved a similar provision, as the notice given to group members in that case differed with respect to the timing of the notice and the stage of the litigation. However, her Honour also remarked that "it is difficult to conceive of a circumstance in which it would be appropriate".[4] The differing approaches may become important factors as to where class actions are commenced as the Victorian approach provides a greater return for the funder.

In order to ensure that the unfunded group members would not receive what Gordon J described as a "windfall", her Honour proposed that the amount which would have been deducted and paid to CLF under the scheme should be pooled and distributed pro rata to all group members.

Referred to as the "equalisation factor", the above approach has been used in a number of class action settlements.[5] This ensures that the funder's fee is effectively shared by all group members regardless of whether they are funded or not and as a result, the burden of the funder's fee is shared by all. At the same time, the litigation funder is not able to recover more than it is contractually entitled to.

Whilst her Honour indicated that this would result in an outcome that was "fair and reasonable to all",[6] there are arguments to suggest that unfunded group members' interests need to be further protected. Evidently, unfunded group members will receive less from the settlement fund when the equalisation factor is applied. In the absence of effective regulation overseeing the fees charged by funders, unfunded group members may be penalised for the commercial decision a representative party or a funded group member has made with the funder. It appears prudent for the Court to scrutinise the funding agreements entered into by the funded group members.

APPLICANT/REPRESENTATIVE PARTY'S EXPENSE CLAIM

This claim was described as an amount representing a claim by Modtech for compensation for the time or expenses incurred in prosecuting the claim on behalf of all group members. The scheme proposed that this amount be deducted from the settlement amount prior to the individual group members' entitlements being calculated.

Gordon J raised a number of issues with this particular part of the claim. The claim was made by the principal of Modtech rather than the company, and it was based on his taxable income in the year before he commenced trading in GPT securities. Gordon J pointed out that it was not clear whether that particular financial year was a "usual" or appropriate year as a benchmark for the period that was being claimed. Further, the applicant had not provided the Court with material to enable it to determine the reasonableness of the expenses being claimed, and Gordon J remarked that the items included in the invoice seemed "excessive".[7]

Quoting with approval Jessup J in *Darwalla Milling Co Pty Ltd v F Hoffman-La Roche Limited (No 2)* (2006) 236 ALR 322, the Court noted a number of reservations in that case. One of those included, that similar to the law firm's claim, there was no contradictor. Further, her Honour was concerned about the amount of time allegedly spent on tasks and the nominal hourly rates supplied by the applicants' solicitors as the Court only had the say-so of the claimants. The other major concern was that the evidence did not discriminate between the time and expenditure which related to the preparation of the applicant's case and that which was for the benefit of the group. Only expenditure undertaken for a representative purpose could be reimbursed.

The representative party, as with the other group members, have an interest in minimising the legal and administrative costs, minimising the premium paid to the litigation funder and maximising the amount recovered from the respondent. In GPT, Modtech's own expense claims (as well as the law practice's fees and disbursements) were to be deducted from the settlement sum prior to individual group members' entitlements being calculated. Such an arrangement creates a divergence of interest between the representative party and the group members as the representative party has an interest in securing or maximising the return of their own expense claim over that of ensuring that other costs are reduced.

The Registrar's advice to the Court was that although it was described as an *expense* claim, it was primarily a claim for compensation for time devoted to the litigation by the director of Modtech. The Court adopted the Registrar's recommendation that an amount of $10,000 be approved.

DECISION

The Federal Court referred the law practice's legal costs and Modtech's expense claims to a Registrar who was to conduct an assessment and provide a report to the Court.

Orders were made on 26 June 2013 approving the amended distribution scheme. The proceedings were listed before Gordon J on 19 September 2013 in respect of the claims for legal costs and expenses. Orders approving the legal fees in the amount of $8,565,285.13 and applicant/representative party expenses in the amount of $10,000 were made on 15 November 2013.

LAWYER CONTACTS

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ENDNOTES

1 *Modtech Engineering Pty Limited v GPT Management Holdings Limited* [2013] FCA 626 and *Modtech Engineering Pty Limited v GPT Management Holdings Limited* [2013] FCA 1163.

2 For a discussion of the common fund approach, see Michael Legg, "Reconciling Litigation Funding and the Opt Out Group Definition in Federal Court of Australia Class Actions—The Need for a Legislative Common Fund Approach" (2011) 30 *Civil Justice Quarterly* 52.

3 *Modtech Engineering Pty Limited v GPT Management Holdings Limited* [2013] FCA 1163 at [137].

4 *Modtech Engineering Pty Limited v GPT Management Holdings Limited* [2013] FCA 626 at [60].

5 *Modtech Engineering Pty Limited v GPT Management Holdings Limited* [2013] FCA 626 at [60].

6 *Modtech Engineering Pty Limited v GPT Management Holdings Limited* [2013] FCA 626 at [60].

7 *Modtech Engineering Pty Limited v GPT Management Holdings Limited* [2013] FCA 626 at [66].

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