

Understanding Class action Settlements

Written by the Class actions Committee of the
Federal Litigation and Dispute Resolution Section

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The Class Actions Committee of the Law Council of Australia has prepared this note for the assistance of the media and the public. Its purpose is to provide a general outline of the considerations that influence the terms of settlement in class actions or which explain some of the procedures followed by the courts and lawyers in arranging and then implementing the settlements.

What is a Class Action?

The basic features of the modern class action are quite simple. Where seven or more persons appear to have claims against a defendant, and the claims arise out of similar or related circumstances, *and* all the claims give rise to a substantial common question of law or fact, then any one or more of those persons can commence a class action on behalf of some or all of the persons in the "class".

The person who commences the class action is the "applicant" or "plaintiff". That person instructs the lawyers who run the claim on behalf of the class. The members of the class are usually called "group members".

The important feature of a class action is that the court can resolve the "common questions" raised by the group claims. The decision is then binding on each group member, and on the defendant. This means there only needs to be one proceeding for those common questions, rather than separate proceedings for each group member.

Group Members in Class Actions

The plaintiff does not need permission from the group members, or from the court, in order to commence a class action. But there are at least four mechanisms by which the interests of group members are protected.

First, the court will make orders requiring that group members be notified about the class action and be given an opportunity to "opt out" of it.

Second, the court has a power to order that a proceeding not continue as a class action where the court concludes that the procedure is not appropriate. This is usually called a "de-classing" order.

Third, class actions are always very closely managed by the court. There are regular procedural hearings and case conferences involving the judge and other officers of the court.

Fourth, a class action cannot be settled or discontinued without permission ("leave") from the court. This is the feature of class actions which this note seeks to explain.

Reasons for Class Action Settlements

In the early stages of a class action the plaintiff's lawyers may have only limited information about the total numbers of possible claimants, about the prospects of success on the claims, or about the total value of the claims if they succeed.

As a class action gets near a trial date, so that the parties are in a better position to assess the merits and the total potential value of the claims, the court will order that the class plaintiff, the defendants, and their respective lawyers meet to try to settle the action rather than go to trial. This procedure is called "mediation".

Most class actions will settle at mediation. This is because the risks associated with a trial are usually worth avoiding for each side. Compared to a settlement, a trial will take more time, incur more legal costs, produce an "all or nothing" outcome for each party, and even then carry the risk that the losing party will try to appeal the trial decision.

These influences on settlement discussions are not unique to class actions. They exist in most legal proceedings. But because class actions tend to get more publicity, it is important to recognise that these factors explain why class actions, that might have been announced as claims for very large amounts of compensation, might later be settled for smaller amounts.

Protection of Group Members

It is during the settlement phase of a class action that the court will be most actively involved in ensuring that the interests of group members are appropriately protected.

"Protection" here does *not* mean that the court ensures that every group member gets one hundred per cent compensation. Rather, it means the court addresses two concerns.

First, the court supervises a "notice" procedure, to give group members sufficient information to decide whether to accept, oppose, or try to "opt out" of the settlement.

Second, the court rules in each jurisdiction provide that a class action cannot be settled (or withdrawn) without permission from the court. The requirement that a client's lawyer explain to the court the lawyer's reasons for recommending a settlement is very unusual. It applies only in class actions, or in cases for clients who are children or who are subject to some kind of legal incapacity.

This special procedure places a heavy demand on the plaintiff's lawyers. They are required to deliver to the judge a written opinion which sets out, in great detail, their private professional assessments of the merits of the proposed settlement.

All the courts that use the modern class action procedure expect the highest standards of disclosure from the plaintiff's lawyers in these confidential opinions.

The opinions are provided to the judge before the hearing of the plaintiff's application for court approval of the proposed settlement. Then, during the hearing of the application, the judge will ask searching questions of the plaintiff's lawyers in relation to any aspects of the opinion which are unclear, or about which the judge is not satisfied.

The central question for the court, in these "settlement approval" applications, is whether the proposed settlement is fair and reasonable having regard to the interests of the group members.

If the court is not satisfied that the interests of the group members have been addressed fairly and reasonably overall, it can decline to approve the settlement.

Other Practical Considerations

There are several other features of class action settlements which need to be considered when assessing the reasonableness of any given settlement.

First, although the settlement will almost always be for a *proportion* of each group members' total loss, rather than the whole loss, this is a normal feature of settlements in any kind of litigation.

Second, the reality is that the claims settled in class actions usually could not have been litigated *at all* if the class action procedure had not been used. The costs and risks would have made it unreasonable to run any individual claim.

Third, in a class action the group members do not face the risk of having to pay the *defendant's* legal costs if the claim fails. They might feel that they should have received more compensation than a settlement provides, but they might not have been willing to step into the role of lead plaintiff to pursue that better outcome.

Fourth, the settlement will usually include arrangements for the plaintiff's lawyers to be paid their fees out of the compensation recovered for the group members. These arrangements are closely scrutinised by the court. Only the fees that the court considers reasonable will be approved.

Last, the share of the fees deducted from each group member's individual compensation will almost certainly be a small proportion of the fees that would have been incurred if the group member had hired their own lawyer to run an individual claim.

Settlement Distribution Schemes

Where a class action settles on terms providing for compensation to be paid to the group members, the basic agreement will either be that the defendants will pay a *percentage* of the individual losses to *each* group member, or pay a single dollar figure as a *lump sum* amount to be *shared* among the group members.

Either way, once the settlement is approved by the court, more work will need to be done to assess the rate of compensation for each individual claimant.

It is *always* the case that someone needs to administer the Settlement Distribution Process. Often the "scheme administrator" will be a senior partner from the plaintiff's lawyers' firm of solicitors. This is for reasons of efficiency - the lawyers who ran the action will have accumulated knowledge that will enable them to administer the scheme more efficiently.

The appointment of the plaintiff's solicitors as scheme administrators can be criticised, on the grounds that it puts them in a position of conflict of interest as between their different clients, at the same time as it deprives the clients of the legal service they had been using up to that point.

Different settlement schemes will attempt to address this "conflict" problem in different ways. Most commonly, a scheme will try to ensure that group members are told they will need to seek separate legal advice about any concerns they have regarding steps in the settlement distribution process. Another mechanism is to allow group members to seek an independent "review" of decisions made by the scheme administrator.

These potential problems are well recognised, and can be hard to predict. This is one reason why most Distribution Schemes provide for the court to have a continuing supervisory role, while the scheme is implemented.

Delay in distributing Settlement Funds

Obviously, *delay* in the distribution of class action settlement funds can cause great concern among group members.

In some cases, like shareholder or other investor class actions, the process of assessing the group's individual claims is largely an accounting exercise, based on reliable investment records. Scheme administration is therefore relatively quick.

In other cases, such as "mass tort" claims like bushfire cases, the losses suffered by the group members are varied, complex, and require individual investigation and assessment. Scheme administration is likely to take months, if not years.

But these are also the cases that attract the very closest monitoring by the court. The court has extensive powers to sanction the lawyers for any unreasonable delay, for instance by disallowing costs associated with poor planning or other inefficiencies.

It follows, then, that where there is delay, but no sanction imposed on the lawyers by the court, the time taken is likely to reflect the complexity and scale of the administration exercise.