

CLASS ACTION SETTLEMENT DISTRIBUTION IN AUSTRALIA: COMPENSATION ON THE MERITS OR ROUGH JUSTICE?

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Class actions by nature involve litigation on behalf of numerous group members. When class actions settle, the settlement must be distributed amongst the group members who have suffered loss. The settlement distribution process must be approved by the court and is guided by two requirements: compensation on the merits and efficiency. Compensation on the merits focuses on the substantive law and the underlying compensation principle. Efficiency, or rough justice, involves simplifying the distribution process to make it less costly and quicker by ignoring some group member circumstances relevant to the quantum of the recovery they should make. This article explains those requirements and the manner in which they compete. The article argues that a settled class action can only ever use the compensation principle and substantive law as a guide and strict adherence may give rise to harmful cost and delay. However, too ready an acceptance of rough justice in the name of efficiency can harm both group members and the reputation of the class action procedure.

I INTRODUCTION

Settlement of class actions (also referred to as representative proceedings or group proceedings) is the most common way in which this form of litigation is resolved. A key step in the settlement process is the distribution of the settlement funds to the group members. Distribution of the settlement requires that the headline quantum, which attracts most attention, is broken up and divided amongst the group members who have suffered loss.

The settlement distribution process is guided by two competing objectives. First, individual compensation should reflect the merits of the individual claim so that the group member receives compensation commensurate with the amount to which they are entitled. This is usually compensation as determined by law through the courts. Second, the distribution process is completed in a manner that minimises cost and delay. The objectives compete, or conflict, in that a distribution scheme that seeks to take account of more individual factors, which are relevant to the quantum of recovery so as to reflect the merits of the claim, will be more costly and time consuming, especially when the class action includes both strong and weak claims.

This article explains the requirements for compensation on the merits and efficiency and the difficulties of complying with both requirements in class action settlement distribution schemes. The article then concludes that while a settled class action can only ever use the compensation principle and substantive law as a guide, and strict adherence may give rise to harmful cost and delay, too ready an acceptance of rough justice in the name of efficiency can harm both group members and the reputation of the class action procedure.

II BACKGROUND

On 1 February 1977 the Federal Attorney-General instructed the Australian Law Reform Commission (ALRC) to examine the adequacy of the existing law in relation to class actions.¹ The ALRC set about determining whether it was appropriate or desirable to introduce a new form of procedure that would allow for class actions. The ALRC determined:

An effective grouping procedure is needed as a way of reducing the cost of enforcing legal remedies in cases of multiple wrongdoing. Such a procedure could enable people who suffer loss or damage in common with others as a result of a wrongful act or omission by the same respondent to enforce their legal rights in the courts in a cost effective manner. It could overcome the cost and other barriers which impede people from pursuing a legal remedy. People who may be ignorant of their rights or fearful of embarking on proceedings could be assisted to a remedy if one member of a group, all similarly affected, could commence proceedings on behalf of all members. The grouping of claims could also promote efficiency in the use of resources by enabling common issues to be dealt with together. Appropriate grouping procedures are an essential part of the legal system's response to wrongdoing in an increasingly complex world.²

While the ALRC reported that a class action procedure was necessary to promote access to justice through reducing cost, the ALRC was also adamant that the primary goal of the procedural innovation that it was recommending was 'to enable identified persons who establish their loss to secure the legal remedy the law provides'.³ The class action was not meant to alter the substantive law. Rather the substantive law determined the legal remedy that could be obtained.

Class actions were introduced into Australia through the enactment of the *Federal Court of Australia Amendment Act 1991* (Cth) which provided for 'representative proceedings' through inserting Part IVA into the *Federal Court of Australia Act 1976* (Cth) ('FCA Act'). Part IVA commenced on 4 March 1992. The objectives of class action litigation, according to the Minister's Second Reading Speech, were expressed as follows:

The new procedure will enhance access to justice, reduce the costs of proceedings and promote efficiency in the use of court resources. ...⁴

In Victoria, a procedure for 'group proceedings' was inserted in Part 4A of the *Supreme Court Act 1986* (Vic) with effect from 1 January 2000 by the *Courts and Tribunals Legislation (Miscellaneous Amendments) Act 2000* (Vic).⁵ The Victorian procedure

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¹ Australian Law Reform Commission, *Grouped Proceedings in the Federal Court*, Report No 46 (1988), [1].

² *Ibid* [69].

³ *Ibid* [323].

⁴ Commonwealth, *Parliamentary Debates*, House of Representatives, 14 November 1991, 3176-7 (Michael Duffy, Attorney-General).

⁵ Class action procedures also exist in New South Wales where Part 10 was inserted into the *Civil Procedure Act 2005* (NSW) by the *Courts and Crimes Legislation Further Amendment Act 2010* (NSW) so as to make 'representative proceedings' available in NSW courts from 4 March 2011.

effectively mirrors the Federal regime. The class action procedure sought to facilitate the pursuit of remedies for contravention of legal ‘rights’ as recognised by the substantive law but also to do so in a manner that promoted efficiency and reduced costs.

III SETTLEMENT

Most class actions settle.⁶ However, a class action may not be settled or discontinued without the approval of the Court.⁷ The criteria for approving settlements in the Federal Court has been discussed on a number of occasions⁸ and are now consolidated in Federal Court of Australia, Practice Note CM17, *Representative Proceedings Commenced under Part IVA of the Federal Court of Australia Act 1976*, 9 October 2013.⁹ Practice Note CM17 at paragraph 11.1 and 11.2 states:

When applying for Court approval of a settlement, the parties will usually need to persuade the Court that:

- (a) the proposed settlement is fair and reasonable having regard to the claims made on behalf of the group members who will be bound by the settlement; and
- (b) the proposed settlement has been undertaken in the interests of group members, as well as those of the applicant, and not just in the interests of the applicant and the respondent/s.

When applying for Court approval of a settlement the parties will usually be required to address at least the following factors:

- (a) the complexity and likely duration of the litigation;
- (b) the reaction of the group to the settlement;
- (c) the stage of the proceedings;
- (d) the risks of establishing liability;
- (e) the risks of establishing loss or damage;
- (f) the risks of maintaining a representative proceeding;
- (g) the ability of the respondent to withstand a greater judgment;
- (h) the range of reasonableness of the settlement in light of the best recovery;
- (i) the range of reasonableness of the settlement in light of all the attendant risks of litigation; and
- (j) the terms of any advice received from counsel and/or from any independent expert in relation to the issues which arise in the proceeding.

It has been recognised in Australian class actions that fairness and reasonableness of a settlement requires consideration of not just the overall settlement sum ‘but also the

⁶ See Vince Morabito, *An Empirical Study of Australia’s Class Action Regimes – First Report* (December 2009) 30-36.

⁷ *Federal Court of Australia Act 1976* (Cth) s 33V. See also *Supreme Court Act 1986* (Vic) s 33V and *Civil Procedure Act 2005* (NSW) s 173.

⁸ See eg *Taylor v Telstra Corporation Ltd* [2007] FCA 2008; *Pharm-a-Care Laboratories Pty Ltd v Commonwealth of Australia [No 6]* [2011] FCA 277; *Australian Securities and Investments Commission v Richards* [2013] FCAFC 89, [6]-[8]; *De Brett Seafood Pty Limited v Qantas Airways Limited [No 7]* [2015] FCA 979; *City of Swan v McGraw-Hill Companies Inc* [2016] FCA 343, [32]-[35].

⁹ The Federal Court is currently seeking comment on a revised practice note. However, in relation to settlement and settlement distribution the draft revised practice note is substantially the same as the existing practice note.

structure and workings of the scheme by which that sum is proposed to be distributed among group members.¹⁰

The Practice Note makes specific reference to the distribution process. Paragraph 11.3 states:

An application for the Court's approval of a proposed settlement must be made by interlocutory application. The orders which are commonly made on such an application include orders:

...

- (c) approving any scheme for distribution [of] any settlement payment

Further, Practice Note CM 17 raises for consideration by the court, and requires information from the parties, as to how a settlement will be distributed. Paragraph 11.4 states:

To the extent relevant, the affidavit or affidavits in support [of the settlement] should state:

...

- (c) the effect of [the terms of settlement] on group members (ie the quantum of damages they are to receive in exchange for ceasing to pursue their claims and whether group members are treated the same or differently and why);
- (d) the means of distributing settlement funds;

From quite early in the development of class action jurisprudence around the settlement approval requirement it was accepted that the Court would take into account 'the amount offered to each group member, the prospects of success in the proceeding [and] the likelihood of the group members obtaining judgment for an amount significantly in excess of the settlement offer'.¹¹ However, these factors focused on an overall settlement sum rather than the distribution of that sum amongst group members.¹²

In *Camilleri v The Trust Company (Nominees) Limited*, Moshinsky J explained that settlement approval required consideration of the settlement *inter partes* and *inter se*.¹³ The latter focused on the sharing of compensation among claimants and the need to 'achieve a broadly fair division of the proceeds, treating like group members alike, as cost-effectively as possible'.¹⁴ His Honour then set out a number of factors relevant to the assessment of whether a proposed distribution scheme is fair and reasonable, including 'whether the assessment methodology ... is consistent with the case that was to be advanced at trial and supportable as a matter of legal principle'.¹⁵ The distribution scheme under consideration was found to have been 'constructed to "proxy" the kinds of

¹⁰ *Darwalla Milling Co Pty Ltd v F Hoffman-La Roche Ltd [No 2]* (2006) 236 ALR 322, [41]. See generally Michael Legg, 'Class Action Settlements in Australia — The Need for Greater Scrutiny' (2014) 38(2) *Melbourne University Law Review* 590, 605-608.

¹¹ *Williams v FAI Home Security Pty Ltd [No 4]* (2000) 180 ALR 459, [19].

¹² *Darwalla Milling Co Pty Ltd v F Hoffman-La Roche Ltd [No 2]* (2006) 236 ALR 322, [38].

¹³ *Camilleri v The Trust Company (Nominees) Limited* [2015] FCA 1468, [5]. See also *Foley v Gay* [2016] FCA 273, [7] endorsing the approach.

¹⁴ *Camilleri v The Trust Company (Nominees) Limited* [2015] FCA 1468, [5]. See also *Mercieca v SPI Electricity Pty Ltd* [2012] VSC 204, [37]-[39].

¹⁵ *Camilleri v The Trust Company (Nominees) Limited* [2015] FCA 1468, [43].

damages-assessment principles which the applicants' representatives expect would in substance be adopted at trial'.¹⁶

Similarly, the Supreme Court of Victoria has stated that in assessing the fairness of a settlement

it is necessary to form a view as to the correlation between the amount individual group members will recover under the settlement distribution scheme and the amount they might recover after a trial, necessarily any such comparison can only be performed in a broad manner.¹⁷

The consideration of the settlement *inter se*, or between group members, becomes more problematic where the strength of the claims of the group members is not a constant but, rather, involves claims that are stronger or weaker than other claims. In the Vitamins cartel class action, Jessup J observed that the initial approach taken by the applicant in devising a settlement based on a broad assessment of the prospects of success of the case as a whole, taking into account the strength of the case for each type of vitamin, could not be criticised if undertaken by a single litigant. Such a litigant would be entitled to make trade-offs between claims that were expected to have varying degrees of success.¹⁸ However, in the context of the Vitamins cartel class action settlement, in which some of the vitamins claims had lower prospects of success than others, those claims were held by different group members. Jessup J continued:

However, different considerations apply in the case of a representative proceeding under Pt IVA of the *Federal Court Act*. In the present case, it must be assumed that, unbeknown to themselves, group members with stronger cases would, by participating in the overall settlement, share the advantages of their stronger cases with their fellows who had weaker cases. Under s 33V(1) of the *Federal Court Act*, the role of the court is to protect the interests of those who have no voice at the bar table, and it must be said that there is no obvious reason why the court should not assume that those unheard group members whose cases are strong would regard it as unfair and unreasonable to make compromises in the interests of other group members whose cases are weak.¹⁹

Where the claims that are combined in a class action have different prospects of success, then the settlement distribution should reflect those prospects. Equally, if there is an internal differentiation in the settlement scheme, then that differentiation must reflect substantive differences in the claims, such as the strength of the claim, and not be arbitrary.²⁰ This approach may be put another way: the distribution of settlements should seek to achieve 'vertical equity' (that more deserving claimants receive more than less deserving claimants) and 'horizontal equity' (that similarly situated claimants receive similar awards).²¹

¹⁶ Ibid [47].

¹⁷ *A v Schulberg [No 2]* [2014] VSC 258, [12]. See also *Matthews v AusNet Electricity Services Pty Ltd* [2014] VSC 663, [40] endorsing this approach.

¹⁸ *Darwalla Milling Co Pty Ltd v F Hoffman-La Roche Ltd [No 2]* (2006) 236 ALR 322, [66].

¹⁹ Ibid.

²⁰ *Downie v Spiral Foods Pty Ltd* [2015] VSC 190, [53].

²¹ William Rubenstein, Alba Conte and Herbert B Newberg, *Newberg on Class Actions* (Westlaw, 5th ed 2015) § 13:59 ('Put simply, a court is striving to ensure that similarly situated class members are treated similarly and that dissimilarly situated class members are not arbitrarily treated as if they were similarly situated.');

American Law Institute, *Principles of the Law of Aggregate Litigation*

An example of the failure to achieve vertical equity in a class action settlement distribution is provided by the Vioxx product liability class action which was brought by Graeme Peterson in 2006. Mr Peterson was successful at first instance in relation to his personal claim and achieved favourable answers to a number of common questions.²² On appeal, the Full Federal Court found against Mr Peterson but did not disturb the answers to the common questions.²³ However, those answers were said to illustrate an ‘absence of commonality in relation to many of [the common] questions’.²⁴

The proceedings brought by Mr Peterson and related proceedings by Joan Reeves were subsequently settled and approval was sought from the Federal Court. The terms of the settlement²⁵ were, in summary, if a group member had (1) suffered a myocardial infarction (heart attack) or sudden cardiac death and (2) Vioxx was a current medication when they were injured and they have documentary evidence of having received a specified number of Vioxx tablets within specified timeframes, they would receive the following compensation:

- For living group members, \$2000, provided the total of all payments to living group members does not exceed \$497 500. In the event that the total of all payments to living group members does exceed this amount, each approved eligible living group member will receive one equal share of \$497 500;
- For deceased group members (and approved eligible group members in the Reeves proceeding), \$1500, provided the total of all payments to deceased group members in both the Peterson and Reeves proceedings does not exceed \$45 000. In the event that the total of all payments to deceased group members in both proceedings does exceed this amount, each approved eligible living group member will receive one equal share of \$45 000.

The reasons for the Full Federal Court finding against Mr Peterson became of central relevance to the decision whether to approve the settlement. The Full Federal Court found that Mr Peterson’s personal circumstances — his age, gender, hypertension, hyperlipidaemia, obesity, left ventricular hypertrophy and history of smoking — afforded a ready explanation for the occurrence of his injury independent of the possible effects of Vioxx. Further, because of the causative potential of these circumstances for a heart attack, the court held that it was a matter of conjecture rather than reasonable inference on the balance of probabilities that Vioxx was a cause of Mr Peterson’s heart attack.²⁶ The Full Federal Court also dismissed Mr Peterson’s claims that Vioxx was unfit for purpose or was not of merchantable quality.²⁷

(2010) § 1.04 cmt. f; Carrie Menkel-Meadow, ‘Ethics and the Settlements of Mass Torts: When the Rules Meet the Road’ (1995) 80 *Cornell Law Review* 1159, 1211.

²² *Peterson v Merck Sharp & Dohme (Australia) Pty Ltd* (2010) 184 FCR 1; [2010] FCA 180.

²³ *Merck Sharp & Dohme (Australia) Pty Ltd v Peterson* (2011) 196 FCR 145; [2011] FCAFC 128.

²⁴ *Merck Sharp & Dohme (Australia) Pty Ltd v Peterson [No 2]* [2011] FCAFC 146, [9].

²⁵ *Peterson v Merck Sharp and Dohme (Australia) Pty Ltd [No 6]* [2013] FCA 447, [13]-[15].

²⁶ *Merck Sharp & Dohme (Australia) Pty Ltd v Peterson* (2011) 196 FCR 145; [2011] FCAFC 128, [120], [124].

²⁷ *Ibid* [173]-[175], [179]-[182].

However, Jessup J observed that the reasons of the Full Federal Court did not find that other group members could never recover. Rather, Mr Peterson's case was not representative. Other group members who were prescribed Vioxx may have been able to prove that Vioxx contributed to the occurrence of a heart attack.²⁸ Further, the trial and appeal had determined a number of 'criteria by reference to which the relative strengths and weaknesses of the cases of the various group members would stand to be assessed.'²⁹

The difficulty faced by Jessup J was that the settlement agreement did not take account of the learning produced by the trial and appeal. Consequently, Jessup J observed:

[the settlement] makes no discrimination between group members who have other risk factors which were decisive in the rejection of the applicant's case by the Full Court and group members who have no other risk factors.³⁰

The settlement agreement creates two pre-requisites to recovery — namely, the group member had (1) a heart attack or sudden cardiac death and (2) been prescribed Vioxx — and then group members are treated the same. The settlement ignores the strength of group members' claims and treats strong and weak claims alike. As a result:

Under the proposed settlement, for group members whose circumstances are similar to those of the applicant, the payment of the monetary sum proposed would constitute a windfall. ... On the other hand, for a group member who might, consistently with the reasons of the Full Court, anticipate a favourable judgment, the settlement would represent an obvious injustice.³¹

Jessup J refused to grant approval of the settlement on the basis that it was unfair and unreasonable for the representative party, Mr Peterson, to compromise the claims of those group members who had no other risk factors, on the basis that it enabled the claims of the 'less-deserving group members' to be settled.³² In short, the settlement failed to achieve vertical equity — more deserving claimants did not recover more than less deserving claimants.

The lack of vertical equity was addressed in an amended settlement agreement, which provided for the distribution of the total settlement sum according to a points system. This system recognised the differential impacts of existing personal circumstances presumptively predisposing a person to the occurrence of a heart attack.³³

The above discussion demonstrates that the approach of Australian courts to the design of settlement distribution schemes is to utilise the substantive law and what might be recovered at trial to assess a settlement, but with consideration of the risks of litigation,

²⁸ *Peterson v Merck Sharp and Dohme (Australia) Pty Ltd [No 6]* [2013] FCA 447, [9]-[10], [12].

²⁹ *Ibid* [16].

³⁰ *Ibid* [17].

³¹ *Ibid* [20].

³² *Ibid* [20].

³³ *Peterson v Merck Sharp and Dohme (Australia) Pty Ltd [No 7]* [2015] FCA 123, [2]. In the US, the Vioxx settlement that was negotiated outside of the class actions regime (as a class action was unable to be certified pursuant to Federal Rules of Civil Procedure r 23) employed a points system 'based on a combination of factors seeking to approximate the strength and value of the plaintiff's case': Noah Smith-Drelich, 'Curing the Mass Tort Settlement Malaise' (2014) 48 *Loyola of Los Angeles Law Review* 1, 33.

including failing to establish liability or failing to establish loss or damage. This is to be expected as the class action is meant to be facilitating access to the remedies provided by the substantive law. However, in damages class actions the substantive law is underwritten by the compensation principle. Although the Australian courts have not referred to the compensation principle by name, it is the lodestar for redressing loss or damage, and grounds the substantive law's approach to compensation, which in turn guides the assessment of fairness in class action settlements.

IV SUBSTANTIVE FAIRNESS AND THE COMPENSATION PRINCIPLE

The meaning of compensation in the common law may be traced back to the 19th century and the seminal decisions of *Robinson v Harman* (1848) 1 Exch 850 and *Livingstone v Rawyards Coal Co* (1880) 5 App Cas 25. In *Robinson v Harman*, Parke B explained:

Where a party sustains a loss by reason of a breach of contract, he is, so far as money can do it, to be placed in the same situation, with respect to damages, as if the contract was performed.³⁴

In *Livingstone v Rawyards Coal Co*, Lord Blackburn in the House of Lords stated:

I do not think that there is any difference of opinion as to its being a general rule that, where any injury is to be compensated by damages, in settling the sum of money to be given for reparation of damages you should as nearly as possible get at that sum of money which will put the party who has been injured, or who has suffered, in the same position as he would have been in if he had not sustained the wrong for which he is getting his compensation or reparation.³⁵

The High Court of Australia has endorsed both statements as follows:

The settled principle governing the assessment of compensatory damages, whether in actions of tort or contract, is that the injured party should receive compensation in a sum which, so far as money can do, will put that party in the same position as he or she would have been in if the contract had been performed or the tort had not been committed.³⁶

The High Court went on to state that the rule that damages are compensatory in nature is 'a cardinal concept' and 'one principle that is absolutely firm, and must control all else'.³⁷ Cognate with the compensatory principle is the rule that a plaintiff may not recover more than he or she has lost.³⁸ In *Commonwealth v Amann Aviation Pty Ltd*, Mason CJ and Dawson J observed that the corollary of the principle in *Robinson* 'is that a plaintiff is not entitled, by the award of damages upon breach, to be placed in a

³⁴ *Robinson v Harman* (1848) 1 Exch 850, 855.

³⁵ *Livingstone v Rawyards Coal Co* (1880) 5 App Cas 25, 39.

³⁶ *Haines v Bendall* (1991) 172 CLR 60, 63 (Mason CJ, Dawson, Toohey and Gaudron JJ) (footnotes omitted). See also *Commonwealth v Amann Aviation Pty Ltd* (1991) 174 CLR 64, 98 (Brennan J), 116 (Deane J), 161 (McHugh J dissenting); *Butler v Egg and Egg Pulp Marketing Board* (1966) 114 CLR 185, 191; *Clark v Macourt* (2013) 253 CLR 1, 11 [26] (Crennan and Bell JJ), 18-19 [59] (Gageler J).

³⁷ *Haines v Bendall* (1991) 172 CLR 60, 63 (Mason CJ, Dawson, Toohey and Gaudron JJ) citing *Skelton v Collins* (1966) 115 CLR 94, 128 (Windeyer J).

³⁸ *Haines v Bendall* (1991) 172 CLR 60, 63 (Mason CJ, Dawson, Toohey and Gaudron JJ). See also *Tomlinson v Ramsey Food Processing Pty Ltd* (2015) 323 ALR 1; [2015] HCA 28, [47] (French CJ, Bell, Gageler and Keane JJ) referring to the rule against double recovery.

superior position to that in which he or she would have been in had the contract been performed.’³⁹

In the context of statutory causes of action, such as those applicable to contravention of the prohibition on misleading or deceptive conduct, it is clear that compensation is not limited to measures of damages provided by the common law.⁴⁰ Moreover, principles for assessing damages may have to give way in particular cases to solutions best adapted to give the injured claimant an amount which will most fairly compensate for the wrong suffered.⁴¹ However, while different claims may give rise to different measures of damages, the underlying goal is the same — complete compensation.⁴² The compensatory principle has also been applied in a range of diverse areas such as conversion of chattels, carriage of goods, sale of land and infringement of patent.⁴³

The ramification of the compensation principle is that the aim of compensation is to ‘restore and redress the balance of fairness or justice’ that has been upset by a wrongdoer’s contravention of the law.⁴⁴ To compensate someone for something is to provide that person with ‘a full and perfect equivalent’ for that thing. If they are given more than that, they have been over-compensated, and if given less, under-compensated. The idea of over- or under-compensation implies that the notion of compensation is to provide an exact equivalent — neither more nor less.⁴⁵ Consequently, an important criterion for measuring fairness is that all of those persons ‘who are entitled to compensation ... actually receive compensation and in the amount to which they are entitled’.⁴⁶

V AVERAGING AND ROUGH JUSTICE

The American Law Institute in its *Principles of the Law of Aggregate Litigation* explains that:

³⁹ *Commonwealth v Amann Aviation Pty Ltd* (1991) 174 CLR 64, 28.

⁴⁰ *Henville v Walker* (2001) 206 CLR 459, 470 (Gleeson CJ); *Wardley Australia Ltd v Western Australia* (1992) 175 CLR 514, 525 (both cases discuss s 82 of the *Trade Practices Act 1974* (Cth) which is analogous to *Corporations Act 2001* (Cth) s 1041I, *Australian Securities and Investments Commission Act 2001* (Cth) s 12DA, *Australian Consumer Law* s 236 (Schedule 2 to *Competition and Consumer Act 2010* (Cth)).

⁴¹ *Johnson v Perez* (1988) 166 CLR 351, 355-356 (Mason CJ); *Henville v Walker* (2001) 206 CLR 459, 502 (McHugh J).

⁴² *Marks v GIO Australia Holdings* (1998) 196 CLR 494, 503-504 [17], per Gaudron J (‘the task is simply to identify the loss or damage suffered or likely to be suffered and, then, to make orders for recovery of that amount under s 82’), 510 [38], per McHugh, Hayne and Callinan JJ; *Henville v Walker* (2001) 206 CLR 459, 482 per Gaudron J, 509 per Hayne J (‘the section [82] permits recovery of the whole of the loss sustained by a person who demonstrates that a contravention of Pt V of the Act was a cause of that loss. Neither the words of s 82(1) nor anything in the intended scope and context of the Act suggest some narrower conclusion.’); Colin Lockhart, *The Law of Misleading or Deceptive Conduct* (LexisNexis, 4th ed 2015) 445.

⁴³ Harold Luntz, *Assessment of Damages for Personal Injury and Death: General Principles* (LexisNexis 2006) 5.

⁴⁴ Peter Cane, *Atiyah’s Accidents, Compensation and the Law* (Cambridge University Press, 8th ed, 2013) 403, 416–417.

⁴⁵ Robert Goodin, ‘Theories of Compensation’ (1989) 9 *Oxford Journal of Legal Studies* 56, 59; Benjamin Zipursky, ‘Civil Recourse, Not Corrective Justice’ (2003) 91 *Georgetown Law Journal* 695, 701 (‘The defendant must pay not just any amount, but the amount of the plaintiff’s injury, because the payment is not a penalty per se, but the rectification of an injury that the defendant inflicted’).

⁴⁶ Goodin, above n 44, 409.

Ideally, the amount of compensation a claimant receives should reflect the merits of the claim itself, including the likelihood that the claimant would prevail at trial and the amount the claimant would win.⁴⁷

Such a statement reflects the Australian position. However, the American Law Institute goes on to state:

In practice, the ideal is rarely achieved. Rough justice is normal in aggregate proceedings. In these cases settlements usually involve an element of ‘damages averaging,’ which occurs when an allocation plan ignores some features of claims that might reasonably be expected to influence claimants’ expected recoveries at trial.⁴⁸

Rough justice typically means ‘unfair treatment of a person or cause’.⁴⁹ Here that implication arises because differences between claims are ignored or minimised with the effect that the distribution of settlement funds between group members is not equitable because it does not reflect those differences.⁵⁰ This has led to the concern that the terms negotiated to settle class actions may not resemble a result consistent with the merits of the dispute at issue.⁵¹

The statements about ‘rough justice’ and ‘damages averaging’ are in the context of US damages class actions where the class action must be certified by a court, which includes the court finding ‘that the questions of law or fact common to class members predominate over any questions affecting only individual members’.⁵² This mandates much greater cohesion in the claims of group members than is required in Australia.⁵³ The Australian class action regime allows for groups with less cohesion or, put another way, a greater degree of difference in their claims, to band together in a single class action proceeding.⁵⁴ The greater the differences in the claims, the greater the prospect of ‘rough justice’ and ‘damages averaging’.

⁴⁷ The American Law Institute, *Principles of the Law of Aggregate Litigation* (2010) § 1.04 comment f.

⁴⁸ Ibid. See also John Coffee Jr, ‘The Regulation of Entrepreneurial Litigation: Balancing Fairness and Efficiency in the Large Class Action’ (1987) 54 *University of Chicago Law Review* 877, 917; Charles Silver and Lynn Baker, ‘I Cut, You Choose: The Role of Plaintiffs’ Counsel in Allocating Settlement Proceeds’ (1998) 84 *Virginia Law Review* 1465, 1481-1482; Jack Weinstein, ‘Compensating Large Numbers of People for Inflicted Harms’ (2001) 11 *Duke Journal of Comparative and International Law* 165, 174.

⁴⁹ Bryan Garner (ed), *Black’s Law Dictionary* (Thomson Reuters, 10th ed, 2014). The American Law Institute recognises that the expression can sometimes be a pejorative term: The American Law Institute, *Principles of the Law of Aggregate Litigation* (2010) 53.

⁵⁰ Charles Silver and Lynn Baker, ‘I Cut, You Choose: The Role of Plaintiffs’ Counsel in Allocating Settlement Proceeds’ (1998) 84 *Virginia Law Review* 1465, 1481.

⁵¹ Ralph Winter, ‘Paying Lawyers, Empowering Prosecutors, and Protecting Managers: Raising the Cost of Capital in America’ (1993) 42 *Duke Law Journal* 945, 951; Edward Brunet, ‘Class Action Objectors: Extortionist Free Riders or Fairness Guarantors’ (2003) *The University of Chicago Legal Forum* 403, 407.

⁵² Federal Rules of Civil Procedure r 23(b)(3) (2016).

⁵³ S Stuart Clark and Christina Harris, ‘Multi-Plaintiff Litigation in Australia: A Comparative Perspective’ (2001) 11 *Duke Journal of Comparative & International Law* 289, 297.

⁵⁴ *Timbercorp Finance Pty Ltd (in liquidation) v Collins and Tomes* [2015] VSC 461, [316], [462] (‘A group proceeding can encompass issues which have both common and idiosyncratic dimensions.’); *Kelly v Willmott Forests Ltd (in liquidation) [No 4]* [2016] FCA 323, [213].

‘Rough justice’ has been justified on the basis that a representative may need to adjust or average settlement amounts in light of the practical limitations of compensating many people through a settlement scheme.⁵⁵ Class actions have been said to have foregone perfection in relation to compensation so as to achieve that compensation more quickly and at less cost.⁵⁶ Greater precision may only be possible through increased transaction costs.⁵⁷

The accuracy of a settlement distribution scheme can be reduced or expanded depending on the way in which settlement payments are calculated. The calculation can seek to take account of a number of variables within the group that relate to the strength of a claim so as to provide compensation that reflects the strength of the claim. For example, in the Vioxx class action settlement, the first settlement scheme only considered two factors, namely the group member had (1) a heart attack or sudden cardiac death and (2) had been prescribed Vioxx. After that scheme was rejected by the Federal Court, a new scheme was negotiated that employed a points system which considered a range of personal circumstances that made the person more or less predisposed to a heart attack.⁵⁸

However, the greater the fine-tuning of settlement allocations compared to calculating compensation based on the average group member, the greater the costs that may be incurred.⁵⁹ In *Camilleri v The Trust Company (Nominees) Limited*, Moshinsky J listed as a relevant factor in determining if a settlement should be approved, ‘whether the costs of a more perfect assessment procedure would erode the notional benefit of a more exact distribution’.⁶⁰ Similarly, in the Kilmore East bushfire class action settlement, Osborn JA commented:

The potential claims are so heterogeneous that unless some simplified scheme of assessment is provided, the process of assessment of damages will be impractically costly, contentious and delayed.⁶¹

Costs associated with customising the settlement allocation arise as part of designing the settlement distribution scheme and in administering the scheme after the settlement is approved. The costs incurred by the solicitors (and possibly experts)⁶² to design the distribution scheme may reduce the settlement funds available for group members or increase the legal costs and disbursements that are incurred and usually paid by the respondent as part of a settlement. In the Corrugated Cardboard Cartel class action, an expert designed an econometric model to take account of such factors as the size and

⁵⁵ The American Law Institute, above n 47; Michael Sant Ambrogio and Adam Zimmerman. ‘The Agency Class Action’ (2012) 112 *Columbia Law Review* 1992, 2061.

⁵⁶ Rachael Mulheron, *The Class Action in Common Law Legal Systems* (Hart Publishing, 2004) 51-52.

⁵⁷ John Coffee Jr, ‘The Regulation of Entrepreneurial Litigation: Balancing Fairness and Efficiency in the Large Class Action’ (1987) 54 *University of Chicago Law Review* 877, 919 n 104.

⁵⁸ *Peterson v Merck Sharp and Dohme (Australia) Pty Ltd [No 6]* [2013] FCA 447, [13]; *Peterson v Merck Sharp and Dohme (Australia) Pty Ltd [No 7]* [2015] FCA 123, [2].

⁵⁹ Coffee, above n 57, 918.

⁶⁰ *Camilleri v The Trust Company (Nominees) Limited* [2015] FCA 1468, [43].

⁶¹ *Matthews v AusNet Electricity Services Pty Ltd* [2014] VSC 663, [420].

⁶² See *Jarra Creek Central Packing Shed Pty Ltd v Amcor Limited* [2011] FCA 671, [10], [19], [32]-[35], [40]-[52].

type of cardboard product, the state and end-use category of the customer, and whether or not the customer was classified as a contract customer so as to customise the compensation to the measurable characteristics of each group member.⁶³

Further costs will be incurred to administer the distribution scheme. The applicant's solicitor, now administrator,⁶⁴ must co-ordinate the implementation of the scheme, carry out the necessary assessment of claims and calculation of payments.⁶⁵ This will often require the assistance of experts such as accountants and other lawyers. The greater the focus on the individual merits, the higher the costs. For example, the Bonsoy soy milk product liability class action settlement employed a distribution scheme which required an administrator to determine 'whether, on balance of probabilities, consumption of Bonsoy within the Relevant Period caused the injuries claimed', as opposed to other schemes where causation was assumed.⁶⁶ As a result, a person would need to undergo a medico-legal review, provide information, documents and authorities, and attend meetings.⁶⁷ These costs will reduce the settlement funds available for group members, even though they may frequently be paid out of the interest earned on the settlement fund, rather than from the principal.⁶⁸

Similarly, the more intricate the calculation, the greater the delay in having a settlement distributed to group members. For example, in the Kilmore East bushfire class action, delays in the distribution of the funds from the settlement arose due to 'the unprecedented size and complexity of the settlement'.⁶⁹ The delay resulted in the court allowing for a broader pool of lawyers to act as assessors of the personal injury and dependency claims under the distribution scheme.⁷⁰ There is a trade-off between accurately allocating settlement payments based on the relative strength of group members' claims and reducing delay in concluding the settlement.

It also needs to be borne in mind that the need for greater information to be provided by group members, to allow for the settlement distribution to be customised, may complicate or make more onerous the forms group members need to complete to be able to participate in the settlement. This can have the effect of fewer group members being able to establish their claim or taking the time to participate in the settlement. Consequently, seeking precision in compensation equivalent to the individual

⁶³ *Jarra Creek Central Packing Shed Pty Ltd v Amcor Limited* [2011] FCA 671, [42].

⁶⁴ See eg *Matthews v AusNet Electricity Services Pty Ltd* [2014] VSC 663, [400]; *Foley v Gay* [2016] FCA 273, [17]; *City of Swan v McGraw-Hill Companies Inc* [2016] FCA 343, [48] where the lawyer for the applicant is appointed by the court to administer the settlement fund.

⁶⁵ See eg *Hobbs Anderson Investments Pty Ltd v Oz Minerals Ltd [No 2]* [2011] FCA 1506; *Matthews v AusNet Electricity Services Pty Ltd* [2014] VSC 663, [400].

⁶⁶ *Downie v Spiral Foods Pty Ltd* [2015] VSC 190, [156]. Compare to *Matthews v AusNet Electricity Services Pty Ltd* [2014] VSC 663, [289]-[291], [294].

⁶⁷ *Downie v Spiral Foods Pty Ltd* [2015] VSC 190, [73]-[74].

⁶⁸ See eg *Pharm-a-Care Laboratories Pty Ltd v Commonwealth of Australia [No 9]* [2011] FCA 1111, [4] (clause in settlement distribution scheme providing for payment of administration fees); *Matthews v AusNet Electricity Services Pty Ltd* [2014] VSC 663, [403]-[404].

⁶⁹ Australian Broadcasting Corporation, 'Black Saturday fire victims upset at payout delay and lack of communication from lawyers', *AM*, 6 February 2016 (Simon Lauder) <<http://www.abc.net.au/am/content/2015/s4401573.htm>>. See also Hedley Thomas, 'Black Saturday bonanza for law firm as victims forced to wait', *The Australian*, 9 April 2016 <<http://www.theaustralian.com.au/in-depth/bushfires/black-saturday-bonanza-for-law-firm-as-victims-forced-to-wait/news-story/e568cd7bdb1f5d2d7146187a012910fc>>.

⁷⁰ *Matthews v Ausnet* (Ruling No. 41) [2016] VSC 171.

assessment of each claim may increase costs and undermine the efficiencies that the class action is designed to achieve. Averaging and rough justice may be argued to be a necessary evil in compensating the victims of mass harm.

VI CONCLUSION

While the compensation principle and the court's settlement approval jurisprudence equate fairness with evaluating the distribution of a settlement to group members by reference to the substantive law, it is also clear that a distribution regime cannot precisely replicate the substantive law. The settlement distribution process does not involve a trial before an independent judicial officer who hears competing evidence that is tested through cross-examination, receives argument on the application of the law and resolves the dispute through weighing the evidence, applying that law and giving reasons.⁷¹ Rather, it is an approximation of the litigation process, with that process providing more or less guidance on the specific case depending on the stage at which the proceedings are settled. Precision or accuracy is unlikely to be attainable. The compensation principle and the substantive law are guides for the assessment of fairness in class action settlements, rather than the providers of single, distinct outcomes. Equally, the equation of 'rough justice' with class actions may be detrimental to the victims of mass harm and to the class action procedure.

Rough justice is of greatest concern where the class action combines claims with varying prospects of success. The combination of strong and weak claims in a class action may work to increase the amount the defendant pays to holders of weak claims.⁷² Consequently, if there is 'damages averaging' the class action settlement would also reduce the payments to group members with strong claims. In short, those with weak claims receive a windfall or overpayment, while those with strong claims are underpaid giving rise to an 'obvious injustice'.⁷³

The problem with overcompensating weak claims is not just the injustice it perpetrates on the holders of strong claims, but that it also undermines the reputation of the class action procedure and adds to the arguments that class actions are 'legalized blackmail'.⁷⁴ Professor John Coffee, in his book *Entrepreneurial Litigation*, discusses a range of class action critiques. In relation to the 'extortion critique' he states:

The most plausible theory of extortion is that the inevitable aggregation of strong individual cases with weak individual cases in a class action may give enhanced (and unjustified) settlement value to the weak claims. In effect, the weak cases

⁷¹ Michael Legg and Sera Mirzabegian, 'Appropriate Dispute Resolution and the Role of Litigation' (2013) 38 *Australian Bar Review* 55, 57–61.

⁷² *Darwalla Milling Co Pty Ltd v F Hoffman-La Roche Ltd [No 2]* (2006) 236 ALR 322, [66]; Joseph Grundfest and Michael Perino, "The Pentium Papers: A Case Study of Collective Institutional Investor Activism in Litigation" (1996) 38 *Arizona Law Review* 559, 571–572; Scott Dodson, 'Subclassing' (2006) 27 *Cardozo Law Review* 2351, 2360.

⁷³ *Peterson v Merck Sharp and Dohme (Australia) Pty Ltd [No 6]* [2013] FCA 447, [20].

⁷⁴ Bruce Hay and David Rosenberg, "Sweetheart" and "Blackmail" Settlements in Class Actions: Reality and Remedy' (2000) 75 *Notre Dame Law Review* 1377; Anne Bloom, 'From Justice to Global Peace: A (Brief) Genealogy of the Class Action Crisis' (2006) 39 *Loyola of Los Angeles Law Review* 719, 720.

hide behind the strong. From this perspective, the class action camouflages the weak cases and so arguably extracts overpayments.⁷⁵

The extraction of overpayments only follows if the settlement distribution scheme does not seek to give effect to the compensation principle and pay claims an amount consistent with their merits. In other words, a settlement distribution scheme that considers each claim based on the main factors relevant to prospects of success should offer protection against overpayment and criticisms of the class action procedure. Group members with weak claims may be able to be part of the class action and to shelter behind a representative party whose stronger claim is 'used as the vehicle for determining the common questions in the action',⁷⁶ but the weak claims recover based on their own merits.

Group members with strong claims who do not receive an allocation of compensation commensurate with the strength of the claim may feel unjustly treated. The experience with US shareholder class actions is that institutional investors have chosen to opt out where they 'believe that, in a class action, their stronger claims will be combined with weaker claims to dilute their ultimate share of the settlement value'.⁷⁷ The benefit of choosing not to participate in the class action and instead to bring an individual claim has been examined by comparing the recoveries achieved by the class action with the recovery achieved by institutional investors.⁷⁸ For example, the AOL class action obtained a settlement of \$2.5 billion which translated into a per share recovery of 60 cents. Institutions that opted-out did significantly better than if they had stayed in the class, as shown by Table 1.⁷⁹

⁷⁵ John Coffee, *Entrepreneurial Litigation* (Harvard University Press, 2015) 135.

⁷⁶ Federal Court of Australia, *Practice Note CM17 – Representative Proceedings Commenced under Part IVA of the Federal Court of Australia Act 1976*, 9 October 2013, [2.2].

⁷⁷ James Cox and Randall Thomas, 'Does the Plaintiff Matter?: An Empirical Analysis of Lead Plaintiffs in Securities Class Actions' (2006) 106 *Columbia Law Review* 1587, 1605. See also Kendra Langlois, 'Note, Putting the Plaintiff Class' Needs in the Lead: Reforming Class Action Litigation by Extending the Lead Plaintiff Provision of the Private Securities Litigation Reform Act' (2002) 44 *William & Mary Law Review* 855, 876; Joseph Grundfest and Michael Perino, 'The Pentium Papers: A Case Study of Collective Institutional Investor Activism in Litigation' (1996) 38 *Arizona Law Review* 559, 571-72 (describing strategic benefits of class actions for weaker claimants and disadvantages for stronger claimants).

⁷⁸ John Coffee, 'Litigation Governance: Taking Accountability Seriously' (2010) 110 *Columbia Law Review* 288, 312. A similar phenomenon has been observed in relation to cartel and mass tort class actions in the US where there are group members with large individual losses: 317-318.

⁷⁹ *Ibid* 312.

Table 1 *The AOL Time Warner Differential*

Institutional Investor	Opt-Out Settlement	Estimated Improvement over Share of Class Recovery
University of California	\$246 million	16-24 times better than class
Ohio Pension Funds	\$175 million	\$9 million (over 19 times better than class)
CalPERS	\$117.7 million	17 times better than class
CalSTRS	\$105 million	7 times better than class
State of Alaska Funds	\$50 million (on \$60 million claim)	80%+ recovery was '50 times better than class recovery'

While choosing to opt out has been linked to maximising recovery, institutional investors have also listed as reasons for suing alone as: pursuing additional claims, controlling litigation strategy and settlement, suing in a preferred (often state-court) forum, leveraging their position to demand corporate-governance changes, and receiving settlement funds quickly.⁸⁰ As a consequence, it cannot be said that claimants with strong claims always choose to leave the class action because of the strength of their claims. However, it does make intuitive sense that if class action settlement distributions that provide for averaging are approved, then an entity with a strong claim may prefer to pursue that claim alone.

The ability of those with the most valuable claims to opt out and litigate on their own behalf has been argued to operate as a type of protection against strong claims being undercompensated.⁸¹ However, in Australian class actions, the settlement distribution regime may only be decided after the time to opt out has passed.⁸² As a result, group members may only learn that they are being unfairly treated once their right to exit has expired.⁸³ This may mean that group members will make their decision to opt out based on the reputation of the class action, rather than the actual settlement distribution regime that is employed.

While allowing for strong claims to opt out might be seen as providing some protection to the holders of those strong claims, it also affects those holding weak claims. The ramification for the group members with weaker claims is that it may reduce the value of the class settlement in total, because the settling defendant must retain sufficient funds

⁸⁰ Elizabeth Chamblee Burch, 'Optimal Lead Plaintiffs' (2011) 64 *Vanderbilt Law Review* 1109, 1132.

⁸¹ Jack Weinstein, 'Compensating Large Numbers of People for Inflicted Harms' (2001) 11 *Duke Journal of Comparative and International Law* 165, 174.

⁸² In some class actions that settle early the opt out and settlement notices may occur at the same time: *Inabu Pty Ltd v Leighton Holdings Limited* [2014] FCA 622.

⁸³ See *Kelly v Willmott Forests Ltd (in liquidation) [No 4]* [2016] FCA 323, [6] where the detrimental effect of a settlement term was not known at the time of the right to opt out. Murphy J raised for consideration the need to allow for a second right to opt out for group members where the first opt out opportunity occurred prior to the terms of a proposed settlement being made available to group members: [136][140].

to cover the high-value opt-outs whose claims it must resolve separately through the ordinary civil litigation process.⁸⁴ If the class action proceeds, then the harm to those with weaker claims may be minimal as any settlement would presumably reflect the strength of their claims. Indeed the combination of numerous weak claims may result in their having a greater value than if they were to be litigated individually due to the risk to the defendant of losing the litigation, even if the probability of such a loss was low.⁸⁵ However, to be weighed against this is that numerous weak claims may find it difficult to attract the support of a lawyer and/or litigation funder with the result that no class action is commenced.⁸⁶ While it may be argued that the weak claims hide behind the strong claims, it also follows that the strong claims may enable the weaker claims to be brought.

The courts and legal practitioners need to balance compensation on the merits and efficiency. 'Rough justice' or averaging of damages must occur to some degree in a class action settlement so as to minimise cost and delay. However, it remains necessary to strive for a settlement distribution scheme that is consistent with the compensation principle and the substantive law. Otherwise class actions may be detrimental to some victims of mass harm and undermine the class action procedure.

⁸⁴ Richard Nagareda, 'The Pre-Existence Principle and the Structure of the Class Action' (2003) 103 *Columbia Law Review* 149, 200. In an Australian context, see eg *Inabu Pty Ltd v Leighton Holdings Ltd* [2014] FCA 622, [6] (The settlement agreement allowed for a large shareholder opting out of the settlement to be dealt with by Leighton being able to require an amount in respect of such a group member to be held in escrow for a period of two years.).

⁸⁵ Charles Silver, "'We're Scared to Death': Class Certification and Blackmail' (2003) 78 *New York University Law Review* 1357, 1373–1375; Michael Legg, 'Shareholder Class Actions in Australia - The Perfect Storm?' (2008) 31 *UNSW Law Journal* 669, 699-701.

⁸⁶ John Walker, Susanna Khouri and Wayne Attrill, 'Funding Criteria for Class Actions' (2009) 32 *UNSW Law Journal* 1036.