Premium Income Fund

NSX Release: 27 March 2015

Federal Court Judgement Hodges v Waters (N0 7) 120151 FCA 264

Justice Perram has handed down his reasons in relation to the judicial advice sought from the Court under section 63 of *the Trustee Act 1925* (NSW).

A copy of his judgement is attached.

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FEDERAL COURT OF AUSTRALIA

Hodges v Waters (No 7) [2015] FCA 264

Citation:	Hodges v Waters (No 7) [2015] FCA 264
Parties:	**CHARLES HODGES & MARK HODGES AS TRUSTEES OF THE CHARLES HODGES SUPERANNUATION FUND v ANDREA JANE WATERS, KPMG, WELLINGTON INVESTMENT MANAGEMENT LIMITED, OCTAVIAR LIMITED (ADMINISTRATOR APPOINTED), GUY HUTCHINGS, JOHN ARTHUR WHATELEY, JACK SIMON DIAMOND, CRAIG ROBERT WHITE, DEBORAH BEALE, STEVEN KRIS KYLING, STUART ROBERTSON PRICE, MICHAEL GORDON HISCOCK, MICHAEL CHRISTODOULOU KING, PAUL JOSEPH MANKA, FERNANDO ESTEBAN, RAYMOND KELLERMAN, DAVID MARK ANDERSON, OCTAVIAR LTD (IN LIQUIDATION) ACN 107 863 390 and OCTAVIAR ADMINISTRATION PTY LTD (IN LIQUIDATION) ACN 101 069 390** **WELLINGTON CAPITAL LIMITED ACN 114 248 458 AS RESPONSIBLE ENTITY OF THE PREMIUM INCOME FUND (ARSN 090 687 577) v ANDREA JANE WATERS, KPMG, DAVID MARK ANDERSON, OCTAVIAR ADMINISTRATION PTY LTD (IN LIQUIDATION) ACN 101 069 390, OCTAVIAR LTD (IN LIQUIDATION) CAN 107 863 390, FERNANDO ESTEBAN, RAYMOND KELLERMAN, MANAGED INVESTMENTS PTY LTD (IN LIQUIDATION) ACN 101 634 146, MICHAEL CHRISTODOULOU KING, CRAIG ROBERT WHITE, GUY HUTCHINGS, STEVEN KRIS KYLING, STUART ROBERTSON PRICE, PAUL JOSEPH MANKA, MICHAEL GORDON HISCOCK, JOHN ARTHUR WHATELEY, JACK SIMON DIAMOND and DEBORAH BEALE**
File numbers:	NSD 324 of 2009 NSD 557 of 2013
Judge:	**PERRAM J**
Date of judgment:	27 March 2015
Catchwords:	**TRUSTS AND TRUSTEES** – applicability of reflective

loss principle to unit trusts – jurisdiction of Court to give judicial advice under *Trustee Act 1925* (NSW) – whether power to give such advice enlivened – whether settlement of proceedings by trustee would be breach of trust

PRACTICE AND PROCEDURE – representative proceedings – Court approval of proposed settlement – orders under ss 33V and 33ZF of the *Federal Court of Australia Act 1976* (Cth) – whether settlement terms fair and reasonable

Legislation:

Constitution s 77(i)
Australian Securities and Investments Commission Act 2001 (Cth)
Corporations Act 2001 (Cth)
Federal Court of Australia Act 1976 (Cth) s 33V
Judiciary Act 1903 (Cth) ss 39B(1A), 79(1)
Trustee Act 1925 (NSW) ss 5, 63

Cases cited:

Australian Securities and Investments Commission v Edensor Nominees Pty Ltd (2001) 204 CLR 559 applied
Australian Securities and Investments Commission v Richards [2013] FCAFC 89 considered
Fowler v Airservices Australia [2009] FCA 1189 cited
Harrison v Mills (1976) 1 NSWLR 42 cited
In re Judiciary and Navigation Acts (1921) 29 CLR 257 cited
Johnson v Gore Wood & Co (A Firm) [2002] 2 AC 1 cited
LNC Industries Ltd v BMW (Australia) Ltd (1983) 151 CLR 575 applied
Macedonian Orthodox Community Church St Petka Incorporated v His Eminence Petar the Diocesan Bishop of Macedonian Orthodox Diocese of Australia and New Zealand (2008) 237 CLR 66 applied
Mercedes Holdings Pty Ltd v Waters (No 2) (2010) 186 FCR 450 cited
Mercedes Holdings Pty Ltd v Waters (No 3) [2011] FCA 236 cited
Mercedes Holdings Pty Ltd v Waters (No 5) [2011] FCA 1428 cited
Mercedes Holdings Pty Ltd v Waters (No 8) [2013] FCA 601 cited
Prudential Assurance Co Ltd v Newman Industries Ltd (No 2) [1982] Ch 204 cited
Re Wakim; ex parte McNally (1999) 198 CLR 511 applied
R v Murphy (1985) 158 CLR 596 cited
Stack v Coast Securities (No 9) Pty Ltd (1983) 154 CLR 261 applied
Symond v Gadens Lawyers Sydney Pty Ltd [2013] NSWSC 955 cited

	Webster v Sandersons Solicitors (A Firm) [2009] EWCA Civ 830 cited *Wellington Capital Ltd v Australian Securities and Investments Commission* (2014) 314 ALR 211 cited
Date of hearing:	Judicial advice: 4 November 2014 Sections 33V and 33ZF: 8 December 2014
Place:	Sydney
Division:	GENERAL DIVISION
Category:	Catchwords
Number of paragraphs:	108
Counsel for the Applicant in both NSD 324 of 2009 and NSD 557 of 2013:	Mr MBJ Lee SC and Mr WAD Edwards
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Solicitor for the First and Second Respondents in both NSD 324 of 2009 and NSD 557 of 2013:	Allens
Counsel for the Third and Fifth to Eighteenth Respondents in NSD 324 of 2009 and the Third and Sixth to Eighteenth Respondents in NSD 557 of 2013:	These parties took no active part following various discontinuances by the applicant in NSD 324 of 2009 and various joinders by the first and second respondents in NSD 557 of 2013 but remained privies to facilitate potential claims pursuant to Part IVAA of the *Wrongs Act 1958* (Vic)
Counsel for the Fourth, Nineteenth and Twentieth Respondents in NSD 324 of 2009 and the Fourth and Fifth Respondents in NSD 557 of 2013:	The Octaviar parties did not appear

IN THE FEDERAL COURT OF AUSTRALIA
NEW SOUTH WALES DISTRICT REGISTRY
GENERAL DIVISION NSD 324 of 2009

BETWEEN: CHARLES HODGES & MARK HODGES AS TRUSTEES OF THE CHARLES HODGES SUPERANNUATION FUND
Applicant

AND: ANDREA JANE WATERS
First Respondent

KPMG
Second Respondent

WELLINGTON INVESTMENT MANAGEMENT LIMITED
Third Respondent

OCTAVIAR LIMITED (ADMINISTRATOR APPOINTED)
Fourth Respondent

GUY HUTCHINGS
Fifth Respondent

JOHN ARTHUR WHATELEY
Sixth Respondent

JACK SIMON DIAMOND
Seventh Respondent

CRAIG ROBERT WHITE
Eighth Respondent

DEBORAH BEALE
Ninth Respondent

STEVEN KRIS KYLING
Tenth Respondent

STUART ROBERTSON PRICE
Eleventh Respondent

MICHAEL GORDON HISCOCK
Twelfth Respondent

MICHAEL CHRISTODOULOU KING
Thirteenth Respondent

PAUL JOSEPH MANKA
Fourteenth Respondent

FERNANDO ESTEBAN
Sixteenth Respondent

RAYMOND KELLERMAN
Seventeenth Respondent

DAVID MARK ANDERSON
Eighteenth Respondent

OCTAVIAR LTD (IN LIQUIDATION) ACN 107 863 390
Nineteenth Respondent

OCTAVIAR ADMINISTRATION PTY LTD (IN LIQUIDATION) ACN 101 069 390
Twentieth Respondent

IN THE FEDERAL COURT OF AUSTRALIA
NEW SOUTH WALES DISTRICT REGISTRY
GENERAL DIVISION NSD 557 of 2013

BETWEEN: WELLINGTON CAPITAL LIMITED ACN 114 248 458 AS RESPONSIBLE ENTITY OF THE PREMIUM INCOME FUND (ARSN 090 687 577)
Applicant

AND: ANDREA JANE WATERS
First Respondent

KPMG
Second Respondent

DAVID MARK ANDERSON
Third Respondent

OCTAVIAR ADMINISTRATION PTY LTD (IN LIQUIDATION) ACN 101 069 390
Fourth Respondent

OCTAVIAR LTD (IN LIQUIDATION) ACN 107 863 390
Fifth Respondent

FERNANDO ESTEBAN
Sixth Respondent

RAYMOND KELLERMAN
Seventh Respondent

MANAGED INVESTMENTS PTY LTD (IN LIQUIDATION)
ACN 101 634 146
Eighth Respondent

MICHAEL CHRISTODOULOU KING
Ninth Respondent

CRAIG ROBERT WHITE
Tenth Respondent

GUY HUTCHINGS
Eleventh Respondent

STEVEN KRIS KYLING
Twelfth Respondent

STUART ROBERTSON PRICE
Thirteenth Respondent

PAUL JOSEPH MANKA
Fourteenth Respondent

MICHAEL GORDON HISCOCK
Fifteenth Respondent

JOHN ARTHUR WHATELEY
Sixteenth Respondent

JACK SIMON DIAMOND
Seventeenth Respondent

DEBORAH BEALE
Eighteenth Respondent

JUDGE:	**PERRAM J**
DATE:	**27 MARCH 2015**
PLACE:	**SYDNEY**

REASONS FOR JUDGMENT

I. Introduction

1 This is the final judgment in this very protracted litigation. It sets out my reasons for making a series of orders on 4 November 2014 and 8 December 2014 which disposed of the

proceedings in their entirety by approving a settlement of them which had been reached. Although there are some peripheral matters with which these reasons must also deal, the substantive issue concerns the Court's reasons for approving a settlement of the class action proceedings (brought on behalf of persons who purchased units in the MFS Premium Income Fund during the period 1 January 2007 to 15 October 2008) and of the other proceedings brought by the Fund's present responsible entity, Wellington Capital. I took the course of making orders immediately and providing reasons at a later date because many of the people involved in this litigation are elderly and I thought it expedient that the settlement proceeds be distributed as promptly as possible.

2 These two proceedings are structurally complicated, have as their subject matter complex commercial arrangements and, therefore, have a correspondingly difficult procedural history.

3 The structure of these reasons is as follows:

I. Introduction

II. The MFS Premium Income Fund

III. The Reflective Loss Problem

IV. Other Problems with the Litigation

V. The Judicial Advice Application

VI. Settlement Issues

VII. Confidentiality

VIII. Some Relevant Principles

IX. Differential Treatment of Current Unitholders

X. The Strength of the Claims

XI. Other Settlement Sums

XII. Conclusions

II. The MFS Premium Income Fund

4 At all times material to the litigation the fund was known as the MFS Premium Income Fund. Except when the context unavoidably requires otherwise, I will refer to it as 'the Fund'. The Fund was, and still is, a property trust and is now listed on the National Stock Exchange of Australia ('NSX'). It was not so listed in the period January 2007-15 October 2008. The Fund encountered severe problems in the second half of 2008 as the global financial crisis

caused a tightening in the credit markets. The value of the units in the Fund was greatly compromised by these events.

5 The Fund was required to have what is known as a 'Compliance Plan' which was to set out the internal compliance arrangements under which it was to be conducted. There was also to be an external person to audit the Fund's observance of the compliance plan and this person was the first respondent, Ms Waters. Ms Waters was a member of the firm KPMG which is the second respondent. The gist of the case, stripped of considerable detail, is that the Fund entered into a large number of loss making transactions which were not in accordance with its compliance plan. It is alleged that the auditor of the compliance plan should have detected these breaches of the compliance plan and that, had it done so, the losses would not have been suffered. Although there are a large number of defaults alleged, the most prominent allegation is that the auditor failed to detect that a number of the loss-making transactions were with related parties.

6 The Court has not been asked to determine what caused the Fund to fail, although had the case run to trial it would undoubtedly have been required to do so. At this stage one can at least say that the potential candidates include:

(i) illegal or fraudulent behaviour by some of those involved in its management;

(ii) bad investment decisions;

(iii) the credit crisis; or

(iv) a combination of one or more of the above.

7 These reasons will not resolve that debate. But the short list provided above does afford valuable context in the process of considering the extent of Ms Waters' and KPMG's liability for what occurred.

8 In 2009 a group of present and former unitholders in the Fund commenced an open-class representative proceeding against Ms Waters and KPMG, many of the persons involved in the management of the Fund and its former responsible entity, Octaviar Limited. The allegations made were very complex. While the initial pleading ran to a mere 70 pages, the first proposed amendment sought to expand it by some 501 pages – a prolix articulation that was rejected. At that time the class action was known as *Mercedes Holdings v Waters*. Subsequently, Charles and Mark Hodges as the trustees of the Charles Hodges Superannuation Fund became the lead applicants and the proceedings then became known by

their present title, *Hodges v Waters.* As mentioned above, the class was defined to consist of persons who had purchased their units in the Fund in a period between 1 January 2007 and 15 October 2008. This has generated a class consisting of people who are still unitholders in the Fund but also people who have subsequently disposed of their units. As will be seen, this class structure has brought with it great complexity.

III. The Reflective Loss Problem

9 From their inception the class action proceedings have suffered from a complex legal difficulty known as the reflective loss problem. It is necessary to understand that problem to grasp these reasons for judgment. The problem is as follows: the responsible entity of a managed investment scheme is a trustee for its members (see s 601FC(2), *Corporations Act 2001* (Cth)). Except in some unusual cases, the right to sue for harm done to a trust is vested in the trustee and the beneficiaries of that trust – here the unitholders in the Fund – cannot sue in their own names. If the trustee refuses to sue or if the trustee is itself the target of the claim the usual course is for the trustee to be replaced by a new trustee (often by a court) who will sue.

10 The unitholders and former unitholders who have brought the class action evaded this restrictive principle by seeking by way of compensation not the relief to which the trustee of the Fund might have been entitled had it sued but, instead, what they said was the individual harm caused to them by the diminution in the value of their units. By this route they evaded the force of the submission that they were usurping the trustee's role.

11 The legal ingenuity of this may be admired but it came at the price of bringing them face to face with a principle of company law known as the reflective loss principle: see, for example, *Prudential Assurance Co Ltd v Newman Industries Ltd (No 2)* [1982] Ch 204; *Johnson v Gore Wood & Co (A Firm)* [2002] 2 AC 1. This principle, which is well established and orthodox, seeks to avoid double recovery and in so doing it locates the right to sue for harm done to a company in the company alone and bars shareholders from bringing claims for diminutions in the value of their shares. Thus, to give an example, if a ship negligently harms a wharf owned by BHP Billiton, it is BHP Billiton which can sue for harm to its property and not its shareholders, who are prevented from suing to recover the corresponding diminution in the value of their shares. It is because a share's value is often a function of the value of the underlying assets of the company that a diminution in the value of those assets will be 'reflected', albeit not necessarily exactly, in a diminution in the value of the shares.

12 Of course, the Fund is not a company but from the start of the litigation Ms Waters and KPMG argued that this principle also applied to unit trusts such as the Fund. Indeed, early on they applied to this Court summarily to dismiss the 'reflective' claims on the basis of the principle.

13 I twice declined pre-emptorily to dismiss the class action proceedings on this basis, holding instead that the application of the reflective loss principle to unit trusts was not unarguably correct and noting that the principles underlying reductions of capital were not entirely analogous as between companies and trusts: *Mercedes Holdings Pty Ltd v Waters (No 2)* (2010) 186 FCR 450 at 473-476 [101]-[112]; *Mercedes Holdings Pty Ltd v Water (No 3)* [2011] FCA 236 at [36]-[56]. This observation was important because some authorities identify the reflective loss principle as a corollary of the rule which prevents reductions of capital without court leave in company law. Here the idea is that if shareholders recover loss which is the company's loss a disguised capital reduction occurs. The company's capital on this view includes its causes of action and rights to damages against those third parties who have caused it loss. If a shareholder recovers damages from that third party for harm to the value of its shares in the company then it would be obviously unfair to permit the company to recover for the same loss since the third party would then be required to pay twice. Further, to the extent that a shareholder and the company both recovered this would leave the shareholder doubly enriched. Yet, if the company is prevented from recovering when the shareholder already has (by the notion that double recovery is not to be permitted) then the shareholder who has recovered for harm to the value of her shares has reduced the capital of the company. In effect, the shareholder has by her suit recovered the company's own property thereby reducing its assets and capital and adversely impacting on its creditors and other shareholders: see *Johnson v Gore Wood & Co (A Firm)* [2002] 2 AC 1 at 62 per Lord Millett. The rules surrounding the governance of corporations (most recently the *Corporations Act 2001* (Cth)) have long forbidden such capital reductions without prior Court approval because of the deleterious effect they can have on creditors.

14 The decisions in *Mercedes Holdings Pty Ltd v Waters (No 2)* (2010) 186 FCR 450 and *Mercedes Holdings Pty Ltd v Waters (No 3)* [2011] FCA 236 did not conclude that the unitholders *were* entitled to sue for their reflective losses, only that their contention that they could was sufficiently arguable so as to warrant the significant public expense of a large trial of the present kind. The contrary position of Ms Waters and KPMG was not, however, without force for at least two reasons. First, the English Court of Appeal had already held

that the principle *did* apply to trusts: *Webster v Sandersons Solicitors (A Firm)* [2009] EWCA Civ 830 at [31] per Lord Clarke of Stone-cum-Ebony MR, Arden and Lloyd LJJ. Secondly, the capital reduction rules for companies were amended in 2010 in this country to permit payment of dividends out of capital so long as solvency was not threatened: see s 254T *Corporations Act 2001* (Cth). Although the principle which prevents recovery of reflective losses is to an extent premised on the need to avoid surreptitious reductions in capital, the abolition of that prohibition in the case of dividends does not appear, at least at this stage, to have dented the existence of the principle: cf. *Symond v Gadens Lawyers Sydney Pty Ltd* [2013] NSWSC 955 per Beech-Jones J. This might suggest that the fact that capital reductions may perhaps be more readily achievable in a unit trust (cf. *Wellington Capital Ltd v Australian Securities and Investments Commission* (2014) 314 ALR 211 at 224 [37] (HC)) does not lead to the result that the principle ought not to apply.

15 I mention these matters at some length because it was plain that despite *Mercedes (No 2)* and *Mercedes (No 3)* the class action always had a very significant exposure to being defeated by the reflective loss principle.

IV. Other Problems with the Litigation

16 From the beginning, the class action proceedings were also mired in interlocutory disputations about the adequacy of the pleadings. It is not necessary to recite the details of this long and difficult phase in the litigation, although the insomniac will find it set out in *Mercedes Holdings Pty Ltd v Waters (No 5)* [2011] FCA 1428 at [1]. At [78] in that decision the Court said that parties 'now steel themselves for a long and drawn out procedural Stalingrad in which no quarter will be given'. The 16 interlocutory judgments which have been given in the litigation (and which appear in the schedule to these reasons) show the correctness of that pessimistic appraisal.

17 It suffices to note that this phase was brought to an end by the Court's decision in *Mercedes Holdings Pty Ltd v Waters (No 3)* [2011] FCA 236. In that decision the Court struck out as unviable all class action claims except those in negligence and directed that a fresh pleading be delivered limited to 50 pages.

18 The first difficulty from which the class action proceedings suffered was, therefore, an inability to articulate with any clarity just exactly what the case was. It was that inability which led to the decision in *Mercedes Holdings Pty Ltd v Waters (No 3)* which gave the applicants one last chance to get their house in order. A substantial costs order was made

against them at that time because the manner in which the litigation was being conducted on their behalf was unfair to the other parties to the case. The Court said this (at [123]):

> '123 I refuse to grant leave to the applicants to file the proposed pleading. In light of the above conclusions the only claim which is presently viable is the claim in negligence against the auditors. I will not, however, grant leave to pursue that claim in the absence of an articulated document. I am concerned about the manner in which the applicants have approached the drawing of their pleadings. That which has been articulated on the two most recent occasions is intolerable. This case, although potentially complex, does not warrant a pleading running to over 600 pages. This is particularly so when it has now become apparent that the applicants' advisors have only had access to the five volumes of the Core Documents. The extraction of a two volume pleading from a five volume set is cause for disquiet, particularly when the only point of the five volume set lies in what it is said not to contain. That signals to me the presence of one of three things: a desire to give the claim the appearance of substance when, in truth, nothing of any substance is known about the respondents; a lack of clarity and discipline in drawing the pleading; or, a misguided perception that length is somehow a virtue. In any event, regardless of the reason for this prolixity it must cease. It is oppressive for all concerned and borders on an abuse of the Court's processes. I attempted to indicate as much to the applicants' advisors in *Mercedes (No 2)* at [6] in a way which I thought was clear but I must now conclude that that approach was ineffective. In those circumstances, I have no choice but to take the unusual step of imposing a 50 page limit on any further attempts.'

19 The applicants, at this point, underwent something of a reformation. Fresh (briefer) pleadings were articulated which then survived further challenge: *Mercedes Holdings Pty Ltd v Waters (No 5)* [2011] FCA 1428. The difficulty which the applicants encountered in articulating their case was, however, not entirely their own fault although, since they were the parties making the allegations, it was certainly their problem. In the main, it was caused by the fact that their advisors had experienced very little success in accessing the Fund's documents. After the decision in *Mercedes Holdings Pty Ltd v Waters (No 5)* the applicants, who had happened on new solicitors after *Mercedes Holdings Pty Ltd v Waters (No 3)*, redoubled their efforts to obtain the Fund's documents. This involved substantial dealings with the liquidators of the Fund's former manager and others. The new solicitors experienced much more success in these endeavours than their predecessors.

20 A third difficulty with which the applicants had been confronted was the reflective loss problem referred to above. That problem became more acute on 19 June 2013. On that day the applicants experienced mixed success. On the one hand, they were once again permitted substantively to amend their pleadings over strenuous objection but, on the other hand, the question of whether their claims for reflective loss could succeed as a matter of law was set

down for a preliminary trial at which its actual correctness (as opposed to its arguability) would be determined: *Mercedes Holdings Pty Ltd v Waters (No 8)* [2013] FCA 601. That trial was to commence on 7 October 2014 and was to be followed immediately by the balance of the proceedings.

21 By this stage matters had become increasingly complex. The applicants and those standing behind them had succeeded in persuading the current responsible entity of the Fund to commence its own action entitled *Wellington Capital Ltd v Waters* NSD 557 of 2013 ('the *Wellington Capital* proceeding'). This proceeding had the potential to outflank Ms Waters and KPMG's pleading of the reflective loss defence because the new responsible entity unquestionably had standing as the trustee to pursue claims about harm done to the Fund by the actions of Ms Waters and KPMG. Indeed, if I may say with respect, it was the obvious party to bring the suit in the first place. If this tactic worked it would have denied Ms Waters and KPMG the benefit of this significant defence.

22 But this suit came with its own difficulties. Many of the causes of action which Wellington Capital had obtained upon its succession to the trusteeship of the Fund were arguably statute barred by the time it commenced its proceeding. The limitation period for negligence, for example, is six years which meant that events occurring before 2007 which caused loss before that date could not viably be pursued.

23 The applicants' advisors were therefore in a difficult situation. They had a suit by the applicants which faced a substantial risk that it would be dismissed because of the reflective loss principle and they had a suit by the trustee which, whilst not having that problem, was arguably statute barred to a significant degree.

24 In that context, the idea of trying the reflective loss issue at the start of the trial on 7 October 2014 was strategically very unattractive to the applicants in the class action. If, as was quite possible, the applicants were on the wrong side of the reflective loss principle, the whole of their proceedings would likely be dismissed with a substantial costs order.

25 Their advisors therefore sought to thwart as best they could the determination of the separate question. It was submitted by the applicants that its determination would have no utility because they did, in fact, make other 'non-reflective' claims. A 'non-reflective' claim is a claim by a unitholder to have suffered loss of an individual kind distinct from any loss suffered to the value of their units. If this contention were correct then the applicants were

justified in their argument that trying the reflective loss question as a preliminary issue would serve no purpose because their non-reflective claims would require resolution regardless of the fate of their reflective claims.

26 I determined in *Mercedes Holdings Pty Ltd v Waters (No 8)* [2013] FCA 601 that the applicants made no non-reflective loss claims and declined an application to amend to raise such claims. This technical, but highly significant, debate turned on the interpretation of the applicants' pleading. Since I had concluded that the applicants did not make non-reflective claims, I determined to continue with the proposed preliminary determination of the reflective loss issue.

27 Understandably, the applicants immediately sought leave to appeal that decision. That application was of substance, as my ruling involved a reasonably contestable interpretation of the pleadings. The appeal was listed for hearing on 16 June 2014. On that day, an in principle settlement of the whole of both proceedings was announced and the hearing was vacated. It was by no means obvious, however, that the applicants were going to lose that application.

28 Since I was the docket judge and have nursed this difficult case from 2009 to its final settlement it is useful that I record my views about the state of the proceedings as at the date on which this in principle agreement was reached:

(a) the unitholders' claim was scheduled to commence on 7 October 2014 with the preliminary determination of the reflective loss issue. There was a substantial chance that if this were allowed to occur that the applicants' claim would be dismissed because of the reflective loss problem and the applicants ordered to pay Ms Waters and KPMG's costs since 2009;

(b) the *Wellington Capital* proceeding did not have that difficulty but it had, what appeared to me to be, substantial limitation issues;

(c) there was an application for leave to appeal on foot which had some prospects of success and, if successful, would inevitably derail the separate question machinery reducing the risk in (a); and

(d) if that occurred, Ms Waters and KPMG would be drawn into a protracted hearing commencing on 7 October 2014 which, in my view and contrary to the views of the parties, would have run well into 2015 at enormous expense. This would have

presented Ms Waters and KPMG with a risk, even if they had won, of substantial non-recoverable losses in the form of costs.

29 At that time, I was unaware of a number of other matters of which, for the purposes of the present application, I have now been informed. But my perception at the time the parties reached their in principle settlement was that:

(a) the applicants were most likely going to lose the separate question and hence their proceedings would be dismissed with costs;

(b) the trial would proceed in relation to the claim by Wellington Capital but those standing behind it would be so damaged by the costs orders in the class action that, having regard to the fact that most of the claim was statute barred, they would have been seeking to exit the proceedings for the least expense as soon as possible;

(c) the position of the applicants after my refusal on 17 March 2014 to vacate the hearing of the reflective loss issue was that they were confronted with a very real prospect of losing at the threshold;

(d) the wildcard in all of this, however, was their application for leave to appeal in the Full Court which had some prospect of diverting the impending difficulties of 7 October 2014.

30 At that point, my assessment, for what it is worth, was that most of the value in the proceedings was tied up in the application for leave to appeal.

31 I turn then to the first of the main issues for consideration and that is whether Wellington Capital, as trustee, would be justified in settling its 2013 case on the proposed terms, i.e., the issue of judicial advice.

V. The Judicial Advice Application

32 This issue concerns only the *Wellington Capital* proceeding. Since it took over as the responsible entity for the Fund, Wellington Capital has held the Fund's property on trust for the benefit of the unitholders in accordance with the terms of the Fund's constitution. In settling the proceeding it has brought against Ms Waters and KPMG it exposes itself to the potential risk that it will be said by the Fund's present unitholders that it has engaged in a breach of trust, merely by virtue of so settling them.

33 A trustee confronted by a difficult or controversial decision is permitted in New South Wales to approach the Supreme Court of that State for judicial advice. If, upon receipt of the advice, the advice is followed then the trustee is relieved of any liability for breach of trust, provided the procedural requirements of the *Trustee Act 1925* (NSW) ('the Trustee Act') are observed. So much flows from s 63 of that Act which provides:

> '63 Advice
>
> (1) A trustee may apply to the Court for an opinion advice or direction on any question respecting the management or administration of the trust property, or respecting the interpretation of the trust instrument.
>
> (2) If the trustee acts in accordance with the opinion advice or direction, the trustee shall be deemed, so far as regards the trustee's own responsibility, to have discharged the trustee's duty as trustee in the subject matter of the application, provided that the trustee has not been guilty of any fraud or wilful concealment or misrepresentation in obtaining the opinion advice or direction.
>
> (3) Rules of court may provide for the use, on an application under this section, of a written statement signed by the trustee or the trustee's Australian legal practitioner, or for the use of other material, instead of evidence.
>
> (4) Unless the rules of court otherwise provide, or the Court otherwise directs, it shall not be necessary to serve notice of the application on any person, or to adduce evidence by affidavit or otherwise in support of the application.
>
> (5)-(7) (Repealed)
>
> (8) Where the question is who are the beneficiaries or what are their rights as between themselves, the trustee before conveying or distributing any property in accordance with the opinion advice or direction shall, unless the Court otherwise directs, give notice to any person whose rights as beneficiary may be prejudiced by the conveyance or distribution.
>
> (9) The notice shall state shortly the opinion advice or direction, and the intention of the trustee to convey or distribute in accordance therewith.
>
> (10) Any person who claims that the person's rights as beneficiary will be prejudiced by the conveyance or distribution may within such time as may be prescribed by rules of court, or as may be fixed by the Court, apply to the Court for such order or directions as the circumstances may require, and during such time and while the application is pending, the trustee shall abstain from making the conveyance or distribution.
>
> (11) Subject to subsection (10), and subject to any appeal, any person on whom notice of any application under this section is served, or to whom notice is given in accordance with subsection (8), shall be bound by any opinion advice direction or order given or made under this section as if the opinion advice direction or order had been given or made in proceedings to which the person was a party.'

34 Also relevant is s 5 (which defines 'Court' to mean the Supreme Court).

35 On 4 November 2014 I made this order:

> '4. Pursuant to s 63 of the *Trustee Act 1925* (NSW), the Court grants the opinion, advice and direction of the Court that Wellington is justified in compromising the PIF RE Claim on the terms of the Settlement Deed.'

36 At the same time, with s 63(8) in mind, I also made this order:

> '5. Pursuant to s 63(10) of the *Trustee Act 1925* (NSW), the Court fixes 1 December 2014 as the date by which any unit holder must file any application to the Court pursuant to s 63(10), and orders that any such application be returnable before the Court on 8 December 2014.'

37 No application by any unitholder under s 63(10) was made.

38 Three preliminary issues arise before considering the reasonableness of the settlement:

(a) the jurisdiction of the Federal Court to hear an application under s 63 of the Trustee Act and make the orders sought;

(b) the interpretation of the expression 'the Court' in s 63 of the Trustee Act; and

(c) whether the relevant power to provide advice is enlivened.

39 I deal with these in turn.

(a) the jurisdiction of the Federal Court to hear an application under s 63 of the Trustee Act and make the orders sought

40 Leaving aside the (perhaps) anomalous position of the territories, the only power to vest jurisdiction in federal courts is that conferred upon the Parliament by s 77(i) of the *Constitution* ('With respect to any of the matters mentioned in the last two sections the Parliament may make laws: (i) defining the jurisdiction of any federal court other than the High Court; ...'). The Parliament has taken up that invitation in a number of ways including, relevantly, by s 39B(1A)(c) of the *Judiciary Act 1903* (Cth) which confers jurisdiction on this Court 'in any matter... arising under any laws made by the Parliament...'.

41 Wellington Capital, in its proceeding, has explicitly invoked that jurisdiction by seeking relief in respect of what are alleged to be, inter alia, breaches of federal legislation, more particularly, the *Corporations Act 2001* (Cth) and the *Australian Securities and Investments Commission Act 2001* (Cth). Its proceeding is therefore within federal jurisdiction.

42 The application by Wellington Capital for judicial advice is not, on its face, a federal claim. It is an invocation of a remedy which arises under State law designed to operate for the benefit of trustees in New South Wales. It does not appear to answer the description of a matter arising under a law of the Commonwealth within the meaning of s 39B(1A)(c), at least not directly.

43 Nevertheless, it is established that the jurisdiction of a court exercising federal jurisdiction extends not only to the direct federal claims which are presented for its consideration but also to the entire litigious or justiciable controversy between the parties of which the federal claim forms but a part: *Stack v Coast Securities (No 9) Pty Ltd* (1983) 154 CLR 261 at 290 per Mason, Brennan and Deane JJ; *Re Wakim; ex parte McNally* (1999) 198 CLR 511 at 546 [25], [26]; 563-564 [73]-[76]; 583-584 [135]-[136]. A single federal matter may be distributed across several proceedings (as in *Re Wakim* itself) or even across several courts (as in *R v Murphy* (1985) 158 CLR 596 at 614, 617-618; see also *Re Wakim* at 585 [138]). Whether one non-federal claim is part of a broader federal matter is a question of practical judgment and impression but often enough, as in *Re Wakim,* it is useful to ask whether the various claims all arise from a substantially similar common substratum of fact.

44 In this case, the application for judicial advice has taken the form of an application made within the *Wellington Capital* proceeding. At one time this might well have determined that the application was within the accrued jurisdiction. *Re Wakim* establishes, however, that the form the proceedings take is not necessarily determinative of the issue of whether a given claim forms part of a federal matter.

45 This much is apparent, however: the trustee's claim for judicial advice necessarily arises from the same substratum of facts as its actual claim. The questions are admittedly different – instead of asking whether Wellington Capital is entitled to relief the Court asks whether it would be justified in settling a proceeding in which it claims that relief. However, the facts underpinning these are obviously closely related, although not identical. On the judicial advice application what is in evidence is meta-material about the underlying case. I consider that link sufficient to mean it is within the accrued jurisdiction.

46 Two further reasons support the same conclusion. First, these proceedings cannot practically be settled without the trustee obtaining judicial advice. Whilst it is true that Wellington Capital could, if it chose, chance its arm and settle the proceedings without first obtaining judicial advice this would expose it to the possibility of being sued for breach of trust. This

makes it unlikely as a realistic alternative. Consequently, at a factual level the provision of judicial advice may be seen as an adjunct of this Court's own ability to dispose of the matter before it by consent.

47 Secondly, what the trustee is relieved of by the judicial advice is liability for breach of trust. It is relevant that any suit by a beneficiary against Wellington Capital would itself be in federal jurisdiction. This is because any such suit would involve a contention that Wellington Capital had delictually compromised the Fund's federal causes of action. A necessary step in any such proceeding would involve the determination of what those federal rights were which would bring it within federal jurisdiction: *LNC Industries Ltd v BMW (Australia) Ltd* (1983) 151 CLR 575 at 581 ('... a claim for breach of trust... in respect to a right or property which is the creation of federal law... arises under federal law'). It follows that the curtailment of those same rights by s 63 of the Trustee Act must inevitably be in federal jurisdiction too. This means that this Court has jurisdiction with respect to the s 63 claim even if it is not within its accrued jurisdiction. The breadth of that proposition should be recognised: any claim for judicial advice in relation to the compromise of federal causes of actions is in federal jurisdiction. This is the inevitable result of *LNC Industries Ltd v BMW (Australia) Ltd* and a proper appreciation of the concept of a 'matter'.

48 In those circumstances, I conclude that the claim for judicial advice is, in this case, within this Court's jurisdiction. For completeness, it should be noted that, despite the remedy under s 63 being called 'judicial advice' it is not the giving of an advisory opinion which might otherwise contravene the prohibition in Chapter III of the *Constitution* against the giving of advisory opinions in federal jurisdiction: cf *In re Judiciary and Navigation Acts* (1921) 29 CLR 257. This is so for at least two reasons. First, whilst the proceeding is at least initially ex parte, s 63(2) shows what the subject matter of s 63(11) otherwise confirms: that s 63 operates not in a vacuum but directly to curtail actual rights, namely, the right of the beneficiaries to sue the trustee for breach of trust if the advice is followed. There is nothing therefore hypothetical or moot about judicial advice under s 63. Secondly, it binds actual parties, namely, the trustee and the beneficiaries so there can be no suggestion that the determination is at large.

(b) the interpretation of the expression 'the Court' in s 63 of the Trustee Act

49 Wellington Capital's claims for relief were always in federal jurisdiction by reason of its claims under the *Corporations Act* and the *Australian Securities and Investments Commission Act*. This had the consequence of engaging s 79(1) of the *Judiciary Act* which provides:

> '79 State or Territory laws to govern where applicable
>
> (1) The laws of each State or Territory, including the laws relating to procedure, evidence, and the competency of witnesses, shall, except as otherwise provided by the Constitution or the laws of the Commonwealth, be binding on all Courts exercising federal jurisdiction in that State or Territory in all cases to which they are applicable.
>
> ...'

50 The effect of s 79(1) is to make State law, including s 63 of the Trustee Act, binding on this Court if two preconditions are met:

(i) s 63 is 'applicable'; and

(ii) the *Constitution* and the laws of the Commonwealth do not 'otherwise provide'.

51 I have no doubt that s 63 was 'applicable' within the meaning of s 79(1). It became applicable once Wellington Capital sought judicial advice under it. The source of this Court's jurisdiction to entertain the suit, of course, came not from s 79 but it was that section which gave the Court the power to grant the relief.

52 One aspect of s 63 was not, however, picked up by s 79 and this was the definition of the 'Court' in s 5 of the Trustee Act as 'the Supreme Court'. A State statute may be applicable as a source of rights and remedies in federal jurisdiction even though, on its own terms, that law identifies only the courts of the enacting State as the courts to provide those remedies: *Australian Securities and Investments Commission v Edensor Nominees Pty Ltd* (2001) 204 CLR 559 at 591-593 [68]-[71]. Consequently, the effect of s 79(1) in this case is that s 63 is picked up in federal jurisdiction without the definition of 'Court' in s 5 which, at a theoretical level, is inconsistent with the *Constitution*.

53 It follows that this Court has both the jurisdiction and the power to entertain Wellington Capital's application for judicial advice.

(c) Whether power is enlivened?

54 The power in s 63 cannot be exercised unless there is a question respecting the management or administration of the trust property or a question concerning the interpretation of the trust

instrument: s 63(1), *Macedonian Orthodox Community Church St Petka Incorporated v His Eminence Petar the Diocesan Bishop of Macedonian Orthodox Diocese of Australia and New Zealand* (2008) 237 CLR 66 at 89-90 [58] ('*Macedonian Orthodox*'). In this case, the question is directly concerned with a suit commenced to restore trust property. I return to the terms of the proposed settlement shortly but it is sufficient for present purposes to observe that in return for a payment from Ms Waters and KPMG, Wellington Capital will agree to the discharge of its rights as trustee against them. This is a direct question about the management or administration of trust property, namely, the Fund's rights against third parties. Thus the power is enlivened.

VI. Settlement Issues

55 As I have mentioned, the proceedings were settled 'in principle' on the morning of 16 June 2014 and that settlement was formalised by a deed of settlement dated 18 August 2014. The terms of that deed were agreed between the parties to be confidential. I have more to say about the topic of confidentiality below at Section VII. It is not to intrude on the parties' confidences, however, to observe at this stage that the deed was conditional on the applicants obtaining the approval of this Court for their settlement of the class action and on Wellington Capital, as trustee, obtaining judicial advice that its settlement was justified.

56 Unfortunately, because of the reflective loss problem and the shape this has given to the proceedings, the theoretical positions of each of the persons involved in the settlement are not the same. To give some flavour of the problems which exist:

(a) any money obtained by the trustee for harm done to the trust assets will increase the value of the units which are held by the *present* unitholders. Not all of those unitholders, however, acquired their units during the class definition period of 1 January 2007 to 15 October 2008, i.e., not every current unitholder in the Fund is a class member;

(b) the class action claim is principally for reflective loss suffered by persons who were unitholders in the class definition period. They claim for the diminution in the value of their units;

(c) those class members need not have retained their units, i.e., not all class members are present unitholders. Worse, amongst those that have sold their units, they will have sold at different times and for different prices; and

(d) for those class members who remain unitholders they will also be enriched by any funds recovered by the trustee in its action as well as by their class action claim, i.e., they recover twice.

57 These issues generated the need to clarify what would happen with the settlement money and to whom it would go. There were two aspects to this. The first concerned the need to identify with more precision the persons who would take part in the settlement. The second concerned the determination of some in principle mechanism for distributing the proceeds of the settlement as between the different potential groups of current and former unitholders.

58 These two issues were intertwined and could only be determined together. Until the number of persons sharing in the settlement was determined, the amount they would receive could not be known. A draft scheme of distribution was prepared which attempted to solve the fairness issues as between the various categories of current and former unitholder. One feature of this draft was that no monies would pass directly to the Fund, but instead payments would be made to individual persons. This avoided the potential double compensation issue to which reference has been made.

59 On the other hand, another feature of it to which it will be necessary to return, was that *current* unitholders who were not members of the class action would not receive anything. To clarify who was in the class and to enable distribution it was necessary for persons to register their claims. On 22 August 2014 I made a series of orders which were designed to provide for a regime under which class members who were intending to participate in the settlement could become registered. I directed that each member of the class be sent a registration form informing them, inter alia, of the amount of compensation they were likely to receive (using the draft settlement scheme) and of their need to register if they were to participate in the settlement. Advertisements were also placed in newspapers.

60 Each notice contained an estimate of what each class member would receive. A call centre was set up to field inquiries. A cut-off date for registration was imposed of 1 October 2014. A large number of late registrations were received after that date but by subsequent order I permitted a further 129 persons nevertheless to participate in the settlement. Further orders made on 4 November 2014 required notices to be sent informing the class members of their right to object to the settlement at the hearing scheduled for 8 December 2014.

61 Procedurally there were then set in chain two sets of events. The first was Wellington Capital's application for judicial advice pursuant to s 63 of the Trustee Act. The second was an application by the applicants for approval of the settlement.

62 Wellington Capital's application for judicial advice came before me on 4 November 2014. I gave the advice on that day that Wellington Capital would be justified in settling the proceedings on the basis of the deed of settlement but fixed for 8 December 2014 the hearing of any application by any current unitholder opposing that course under s 63(10) of the Trustee Act. The effect of the settlement was that unitholders who were not class members would not receive any share of the settlement whereas unitholders who were would. For reasons I give later this did not involve a breach of the trust by Wellington Capital. However, so the opposite view could be put I directed Wellington Capital to notify all unitholders of this outcome and to notify them of their right to appear in this Court on 8 December 2014 to oppose this course under s 63(10). This was done by a notice on the NSX. Pending that hearing, s 63(10) of the Trustee Act prevented any distribution by the trustee under the advice.

VII. Confidentiality

63 The settlement agreement and the distribution scheme are agreed between the parties to the litigation to be confidential. The operation of the settlement deed is such that its confidentiality is a condition precedent to the settlement taking place.

64 There is no question about the power of the Court to approve a confidential settlement either of representative proceedings under s 33V of the *Federal Court of Australia Act 1976* (Cth) (see, for example, *Fowler v Airservices Australia* [2009] FCA 1189) or of trust proceedings under s 63. The more difficult question is whether that power should be exercised in this case. The options were but two:

(a) to refuse to approve the settlement under s 33V or to give the judicial advice under s 63 in which case the proceedings would continue until they were tried or another non-confidential settlement was reached; or

(b) to approve the settlement notwithstanding its confidential nature.

65 Neither course is attractive. As to (a), making the case run merely because the settlement is confidential ensures transparency of process but creates a great deal of financial risk in the

process. As to (b), whilst each unitholder has been told their approximate individual settlement sum, none has been told:

(i) the global amount paid by KPMG; or

(ii) the details of the distribution arrangements; or

(iii) the size of some of the funder's fees which are to be deducted from the settlement.

66 It is thus, perhaps, difficult for them to understand precisely how the compensation to be allotted to them has been calculated and more difficult still to put together any argument as to why any such settlement should be refused.

67 In this case, three circumstances seem to me germane in considering whether to accept the confidentiality of the settlement:

(i) as discussed below, I consider the claims against the respondent as being at the weak end of the spectrum and the unitholders' position in the litigation precarious. For the reasons I develop later, the present proposed settlement stands a significant chance of being the class members' best outcome. Scotching it because of concerns about the confidential nature of its terms is not something lightly to be done;

(ii) one of the ends served by the need to get the approval of the Court of any settlement under s 33V is external and independent scrutiny. Notwithstanding that the precise global terms of the settlement are to remain confidential, the fact remains that the Court has had access to all of the terms of the settlement in assessing whether to grant leave under s 33V and has given them anxious consideration. Effectively, the Court exercises a protective jurisdiction in the interests of all class members and does so with full knowledge of every detail of the settlement. This then is not a situation in which there is no scrutiny of the reasonableness of the settlement;

(iii) class members who were sufficiently enthusiastic to see the details of the settlement were provided with them on the execution of appropriate confidentiality agreements. Only one class member, however, took advantage of this.

68 Taking each of those matters into account, this is a case where I conclude that it is appropriate that I not refuse to approve the settlement just because its terms are to remain confidential.

VIII. Some Relevant Principles

69 The issue raised in the Wellington Capital proceeding is whether it should be given the advice which it seeks. The discretion under s 63 is not expressed to be subject to limitations and what will be germane to its exercise will depend upon the context. The sole purpose in giving judicial advice is to determine what ought to be done in the best interests of the trust estate: *Macedonian Orthodox* (2008) 237 CLR 66 at 102 [105]. In this case this devolves to two basic issues:

(i) are the terms of settlement of such a kind that it is in the best interests of the Fund to settle on those terms rather than pursuing the litigation further; and

(ii) is the settlement in the best interest of the Fund notwithstanding its differential treatment of some unitholders.

70 Insofar as s 33V is concerned, the authorities are clear. Approval will be granted to a settlement where it is just to do so and that will be so where the settlement is fair and reasonable having regard to the claims made by the group members who are bound by it. In carrying out the assessment called for by s 33V the Court's function is protective, recognising, as it must, that the interests of the parties before it and those of the class members as a whole may not wholly coincide: see *Australian Securities and Investments Commission v Richards* [2013] FCAFC 89 at [7]-[8]. As *Richards* itself demonstrates, some care must be taken to ensure that the settlement is not only fair as between the parties but also as between individual class members.

71 In light of those principles, I turn then first to the differential treatment of unitholders in the Fund under the settlement.

IX. Differential Treatment of Current Unitholders

72 Under the terms of the settlement the monies recovered from KPMG are to be distributed, first, to those who have funded the action and, secondly, to the class members. Apart from one very minor aspect to do with any surplus in administration costs, the settlement proceeds will *not* be distributed to Wellington Capital as trustee of the Fund.

73 Ordinarily, it would not be in the interests of a trust to settle litigation on the basis that settlement proceeds are to go to a collection of third parties. However, that general proposition may have to yield when the practicalities involved include the fact that the third parties in question consist of present and former unitholders in the trust.

74 Here again the reflective loss problem raises its ugly head. The trustee has rights in tort, contract, under statute and so on to sue Ms Waters and KPMG for harm caused to its position. Those rights have a value. On the other hand, the class members claim to have the right to bring the trustee's claims (as reflective claims). Those claims are for the same loss – diminution in the value of the Fund's assets (in the case of the trustee) and diminution in the value of the units caused by the diminution in the value of the Fund's assets (in the case of the class members).

75 The settlement has been structured such that only members of the class will receive compensation, that is, persons or entities which acquired units in the period 1 January 2007 to 15 October 2008. Significantly, however, there are a substantial body of current unitholders in the Fund who are not members of that class. Although the assets of the trust include the choses in action against Ms Waters and KPMG, these non-class member unitholders will receive nothing as a result of the settlement. In effect, the fruits of the settlement will be diverted to a group made up of some of the Fund's present unitholders together with some former unitholders, the unifying feature being a common acquisition date between 1 January 2007 and 15 October 2008.

76 Thus the settlement deed achieves a distribution which does not treat all current unitholders equally. More specifically, persons or entities which have acquired their units *after* 15 October 2008 are treated, by getting nothing, less favourably than those present unitholders who acquired their units in the class definition period.

77 Two issues arise from this: can this be done and, if it can, ought it to be done? As to the first question, s 63 does not authorise the Court pre-emptively to forgive breaches of trust. I do not think that this Court could affirmatively conclude that the proposed distribution involved a breach of trust and then give judicial advice to permit it. The procedure does not exist to resolve basic controversies: see *Harrison v Mills* (1976) 1 NSWLR 42 at 45 per Needham J.

78 In saying that I do not suggest that the inquiry at hand is into whether a breach of trust would occur. The inquiry is instead into whether it would be reasonable to take the suggested step. The point being made here is a narrower one: the Court would not give judicial advice knowing the suggested step was a breach of trust. This is not to say that in deciding whether to grant judicial advice the Court is positively inquiring into whether there will be a breach. That is not the point of the procedure.

79 The Constitution of the Fund was placed before the Court. There are two relevant clauses. The first is cl 13.2.2 which provides relevantly:

> '13.2 In the administration of the provisions of the Constitution, and the Corporations Act, in relation to the Scheme and the Scheme Property, the Responsible Entity shall have the following powers. These powers shall be in addition to the powers, authorities and discretions vested in it by any other provision of this Constitution or by the Corporations Act and which shall not limit or be limited by, or be construed so as to limit or be limited by the powers, authorities and discretions otherwise by this Constitution or by the Corporations Act vested in the Responsible Entity, that is to say:
>
> 13.2.1. ...
>
> 13.2.2 to institute, join in and defend proceedings at Law or by way of mediation or arbitration and to proceed to the final end and determination or to compromise the same and to compromise and settle any such dispute or proceedings for such consideration and upon the terms and conditions as the Responsible Entity may decide...'

80 Next there is cl 14.7 which provides:

> 'Best interests of Unit Holders paramount
>
> 14.7 The Responsible Entity:
>
> 14.7.1 will perform its functions and exercise its powers under this Constitution in the best interest of all Unit Holders and not in the interests of the Responsible Entity if those interests are not the same as those of Unit Holders generally; and
>
> 14.7.2 subject to sub-clause 14.7.1, will treat the Unit Holders of the same class equally and will treat Unit Holders of different classes fairly.'

81 I do not consider, contrary to Wellington Capital's argument, that cl 13.2 permits the trustee in settling a case under cl 13.2.2 to ignore the requirements of cl 14.7. This is not because the heading to cl 14.7 includes the word 'paramount', resort to which as an interpretational tool is forbidden by cl 2.1 of the Schedule to the Constitution. Rather, it is because the text of cl 13.2 only protects the power in cl 13.2.2 from being read down in the light of 'powers, authorities and discretions' appearing elsewhere in the Constitution and the *Corporations Act 2001* (Cth). Clause 14.7 cannot be described as a power, an authority or a discretion. It is instead a mandatory instruction. As such, it binds the trustee when acting under cl 13.2.2.

82 That is not the end of the matter, however. There is no doubt that the proposed distribution does not treat the unitholders of the same class 'equally'. However, the obligation to treat

them equally is constrained by the opening words 'subject to sub-clause 14.7.1'. That reference establishes that the ultimate end to which the clause is bent is 'the best interests of all Unit Holders'. There can be, as Wellington Capital correctly argued, some circumstances in which the interests of all unitholders might require some of them to be treated differently. It follows that the power to settle proceedings in cl 13.2.2 may be used in a way which treats unitholders differentially but only if this is in the best interests of the unitholders as a whole.

83 In this case, I was satisfied that the proposal was in the best interests of the unitholders as a whole for two reasons:

(a) as discussed below, the trustee's case was weak and the most likely outcome was a loss; and

(b) the trustee's case, in practical terms, could not be settled unless at the same time the class action was settled. As discussed below, it was also a weak case.

84 The relatively small benefit which the unitholders who are class members are to receive and the fact that the other unitholders who are not class members are to get nothing are matters which should not stand in the way of protecting the Fund from the very real risk of an adverse costs order against the trust assets in the likely case of a loss. Without revealing the detail of the settlement, it will suffice to say that the resolution of that question has involved a comparison between:

(a) the likely yield to the unitholders which is being foregone in the name of the price of settling this litigation;

(b) the unequal treatment of unitholders; and

(c) the comparative risk to the Fund if the litigation is allowed to continue.

85 In my opinion, that balance clearly favours the settlement. For that reason, it seemed to me appropriate to give the advice ought.

86 For completeness, the situation in the present case should be contrasted with the situation in *Australian Securities and Investments Commission v Richards* [2013] FCAFC 89. In that case the Court refused to give approval to a settlement where class members were treated differently. The argument in that case had centred around the proposition that one set of class members who had funded the litigation were entitled to a premium in the settlement to which the other (non-funding) members were not to be entitled. The Full Court considered that the distribution was not fair and reasonable to all members because the opportunity to participate

in the funding group was largely limited to the clients of a particular firm of solicitors. It also considered the manner in which the fee was calculated to be unfair.

87 There are obvious procedural differences between *Richards* and the situation in this case, not the least of which is that *Richards* was concerned with s 33V leave and not s 63 advice. However, I do not consider these differences to be material. What is material is the absence of any suggestion in *Richards* that the disparate treatment might have been necessary for the good of the class as a whole. On the other hand, that is the situation in this case. I do not think, therefore, that *Richards* requires any different outcome.

88 On a number of occasions above I have referred to my views on the strength of the claims. It is now useful to elaborate on these.

X. The Strength of the Claims

89 In my opinion, the most likely outcome to this litigation was that it would be lost. There was a high risk that the applicants had no standing to proceed and a good chance the bulk of the trustee's claim was statute barred. There were other risks too. In particular, the applicants in both proceedings had to confront the effect of the proportionate liability legislation which would have reduced KPMG's liability so as to reflect its overall responsibility for the losses which were suffered. Given what is now known about the events inside the Fund at the time giving rise to the losses it is likely, in my opinion, that this reduction would have been substantial. In particular, it is difficult to avoid the conclusion that predominant responsibility for the Fund's failure lay with its management. This is not to say that those auditing the Fund's compliance with its compliance plan bear no responsibility but merely to observe their lesser culpability. Those who fail to prevent the wrongful acts of others are not usually thought of as having the same degree of turpitude as the primary wrongdoer when the issue of apportionment arises.

90 The total amount claimed in the proceedings is approximately $420 million. However, $340 million of that claim has turned out to be probably non-actionable. Allegations were made in the proceedings concerning the MFS Pacific Finance Participation Payment, the MFS Pacific Maximum Yield Fund First Purchase and the MFS Maximum Yield Fund Second Purchase. These totalled in value approximately $150 million. Evidence has now emerged in the Supreme Court of Queensland that these transactions did not occur and were shams to cover other payments out of the Fund. Since it appears they did not occur at all they cannot have caused any loss. One answer to that might be that the auditor, had she become aware of such

a matter, would have informed ASIC of its occurrence and this, in turn, might have resulted in ASIC taking some regulatory step to bring the activities in the Fund to a stop. That possibility is, I think, frankly to be acknowledged but, at least in the context of assessing whether the settlement is reasonable, so too is its speculative nature.

91 The other $190 million relates to the 2008 MFS Living and Leisure Loans and the MFS Administration Payment. Again these appear to reflect efforts by management to secure cash rather than genuine transactions. The same point should be made.

92 A more plausible face value of the claim is therefore around $80 million. An appropriate settlement of the proceedings must reflect the probable, although not certain, outcome that they would be lost. I have seen the total settlement figure and, whilst it will remain confidential, it reflects, in my view, a good settlement given the difficult waters into which the suits had drifted.

XI. Other Settlement Sums

(i) Recoveries

93 Money has been recovered from various third parties which has been utilised to meet the obligations of the unitholders. These total $1,405,000 and reflect payments by some members of the former management who were initially sued. Given the size of the losses this figure may appear modest. However, there were substantial difficulties with these claims, not the least of which concerned the ability of the insurers standing behind management to decline cover. There were also some cases of insolvency.

94 Additionally there was a settlement between the unitholders' representatives flowing from costs orders made for and against the unitholders involving various applications about Ms Waters and KPMG. The settlement resulted in a situation which has had no substantial net effect on the settlement.

(ii) Expenses

95 There are a number of other expenses which are to be paid to the funder behind the class action, IMF Bentham. These include what are referred to as 'combined project costs' of $6,866,243.47 which has been reduced by the settlement sum of $1,405,000 referred to above. A specialist costs consultant, Mr Joseph Mazzeo, has analysed what these costs are and whether they have been reasonably incurred. Before turning to these figures it is worthwhile noting that the unitholders changed solicitors shortly after the hearing to which

Mercedes (No 3) related. They were initially represented by Carneys Lawyers ('Carneys') and then subsequently by HWL Ebsworth Lawyers ('HWL'). The solicitor with carriage of the proceedings at HWL, Mr Robert Johnston, moved to Johnson Winter Slattery ('JWS') in November 2011 and thereafter JWS became the unitholders' solicitors. Senior and junior counsel were engaged by all of these solicitors. The breakdown in the unitholders' costs as at 9 December 2014 is as follows:

Class action (including issues overlapping with Wellington Capital's claim):	
Carneys	
Carneys' professional fees	$376,345.75
Carneys' counsels' fees	$1,036,669.03
Carneys' general disbursements	$85,053.17
HWL	
HWL's professional fees	$505,756.03
HWL's counsel's fees	$235,935.43
HWL's general disbursements	$44,987.14
JWS	
JWS's professional fees	$3,832,685.61
JWS's counsels' fees	$880,842.99
JWS's general disbursements	$873,136.74
Total for class action	$7,871,411.89

96 Of these costs Mr Mazzeo has expressed the following opinion:

> '32. I am experienced in the analysis and evaluation of files in complex commercial litigation including representative and class action proceedings. I am satisfied that the accounts rendered by Carneys, HWL and JWS for the time of its personnel have been properly and reasonably incurred and reflect the work reasonably done for the furtherance of the proceedings. I have also reviewed the disbursements incurred in relation to counsel's feed, expert witnesses, witnesses, sundries, travel and the like and am satisfied the accounts rendered by the firms for this expenditure have been properly and reasonably incurred and reflect reasonable expenditure for the furtherance of the proceedings.
>
> 33. In my opinion, the firms have properly charged their fees and disbursements pursuant to their Costs Agreements. In my opinion no significant costs or disbursements have been incurred unnecessarily or inappropriately. Accordingly, I am of the opinion that the amount assessed by me and proposed to be recovered is fair, reasonable and appropriate in the

circumstances.

34. Whilst the nature of the proceedings changed significantly following the transfer of the matter from Carneys to HWL, I am nonetheless satisfied that the work undertaken by Carneys was appropriate to the proceedings as they stood at that time.

35. Having regard to the three firms having acted in the matter I have been conscious in my review to be aware of possible duplication. I have concluded that there was no material duplication as to work done by Carneys and work subsequently done by HWL and JWS. I have so concluded on the basis that the proceedings as they were formulated and pursued at the time by Carneys ultimately did not proceed and were recast in their present form by HWL.

36. In relation to possible duplication as between HWL and JWS, my review of the file indicates that there is no material duplication as Mr Johnston had the conduct of the matter at both firms.'

97 I accept this evidence. However, it is appropriate that I make some remarks about the size of these fees which, to those unfamiliar with the somewhat unusual nature of this litigation, may appear high. There are a number of factors which have contributed to their magnitude. First and foremost has been a principal opponent, KPMG, which has conducted the litigation with great vigour, giving no quarter and testing the resolve of the class members (and, more importantly, their funder) at every turn.

98 A second matter which has contributed to the expense of this case is the very large number of defendants initially joined to the proceeding. This was a legitimate tactic, I think, and could have paid dividends in the form of more persons at the settlement table with pockets. However, as events have transpired those reasonably anticipated benefits have not materialised because the pockets were largely empty and what has occurred instead has been a substantial increase, at least initially, in the complexity of the proceedings and the number of parties opposing the action.

99 A third matter which attracted my attention during the litigation was the initial difficulties which the applicants had in formulating their pleadings. A long time was spent in this endeavour for which, at least from my perspective, not very much seemed to be gained. And, as I have already said, this phase in the litigation resulted in an order that the applicants pay the costs of all other parties to that point.

100 The evidence before me by the unitholders' current solicitor has persuaded me that this was not quite the wasteful misadventure it appeared to me to be at the time. Mr Johnston says

that these older pleadings have provided useful surveys of the material and that they have provided valuable resources to the new legal team. Further, my inspection of the material before me shows that the costs which had to be paid, or were in fact paid, to KPMG were only $190,000, which in the context of the present settlement is below the Plimsoll line of significance.

101 The funder is also to be paid $150,000 relating to costs incurred before the case was filed. I am satisfied that this, too, is reasonable.

102 There are two other fees which have been included of which brief mention should be made. The first is of $23,600 for Mr Hodges. Mr Hodges has performed a valuable role as, in effect, the lead unitholder in the proceedings. In my opinion, it is reasonable for this modest payment to be made having regard to his strenuous efforts and labours on behalf of the class.

103 The second fee relates to the cost of the various mail outs to class members which have taken place and the call centre set up to deal with them. This amounted to approximately $350,000. This was an inevitable expense in this kind of litigation and was dealt with in an efficient fashion.

(iii) Funders fees

104 I turn then to IMF Bentham's fees. These are commercially sensitive and are confidential. Their confidential nature is a consequence of the agreements which were entered into by the applicants in the proceedings. Whilst I will not set them out I will indicate that they consume just over one third of the settlement monies. This is the flipside of the Faustian bargain constituted by the funding agreements. Whilst they are, in my view, very substantial they reflect the commercial risk that the funder was taking with its own money. I would reserve for another day whether this information should properly remain out of public view. There was always the risk that the case might run and be lost with the concomitant loss by the funder of all of the legal fees it had paid. It was the funder which ran that risk and not the unitholders and it is entitled to a fair reward for that. Whilst that fee has consumed a substantial part of the settlement, it remains the case that without the funder the unitholders would have received nothing at all.

XII. Conclusion

105 In those circumstances, I concluded that the settlement was reasonable, that the trustee would be justified in settling its proceedings on the terms of the settlement deed and that the

differential treatment of the unitholders is justified. In reaching that conclusion I also took into account written advice proffered by senior and junior counsel for the various applicants that, in their view, the settlement was reasonable.

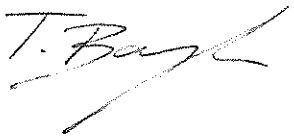
106 The representative proceedings cannot be settled without the leave of the Court under s 33V of the *Federal Court of Australia Act 1976* (Cth). On 8 December 2014 I granted that leave. I did so because the settlement was a fair and reasonable one.

107 At the s 33V hearing on 8 December 2014 Ms Livneh and Mr Grundel appeared to oppose the settlement. In substance their point was that the settlement was insufficient and unfair; also that the distribution mechanism was opaque. As to the former, I do not accept the argument. The proceedings were most likely to end in a heavy defeat. Far from being not enough, the settlement was as good as it was going to get. As to the latter, class members who wanted to access the distribution arrangements were permitted to do so. In any event, I have perused those arrangements and they are reasonable.

108 It was for these reasons I approved the settlement.

I certify that the preceding one hundred and eight (108) numbered paragraphs are a true copy of the Reasons for Judgment herein of the Honourable Justice Perram.

Associate:



Dated: 27 March 2015

Schedule – Interlocutory Judgments

1. *Mercedes Holdings Pty Ltd v Waters (No 1)* (2010) 77 ACSR 265
2. *Mercedes Holdings Pty Ltd v Waters (No 2)* (2010) 186 FCR 450
3. *Mercedes Holdings Pty Ltd v Waters (No 3)* [2011] FCA 236
4. *Mercedes Holdings Pty Ltd v Waters (No 4)* [2011] FCA 666
5. *Mercedes Holdings Pty Ltd v Waters (No 5)* [2011] FCA 1428
6. *Waters v Mercedes Holdings Pty Ltd* (2012) 203 FCR 218 (FC)
7. *Mercedes Holdings Pty Ltd v Waters (No 6)* [2012] FCA 1412
8. *Mercedes Holdings Pty Ltd v Waters (No 7)* [2013] FCA 138
9. *Mercedes Holdings Pty Ltd v Waters (No 8)* [2013] FCA 601
10. *Hodges v Waters (No 1)* [2013] FCA 737
11. *Hodges v Waters (No 2)* [2013] FCA 877
12. *Hodges v Waters (No 3)* [2014] FCA 233
13. *Wellington Capital Ltd v Waters (No 1)* [2014] FCA 329
14. *Hodges v Waters (No 4)* [2014] FCA 472
15. *Hodges v Waters (No 5)* [2014] FCA 965
16. *Hodges v Waters (No 6)* [2014] FCA 1343