MANAGEMENT FEES REVEALED

By Margaret Brain and Damian Gallagher

If you're a personal injuries lawyer in Queensland and your client is either an adult with impaired capacity for financial matters or a minor, you need to understand the fees and charges that they will incur when the damages are eventually invested on their behalf.

In Queensland prior to 1988, judicial opinion differed as to whether administration fees were payable as an item of damage. Following the decision of *Mullins v Duck*,[1] all plaintiffs with a disability were entitled to an additional head of damage to cover the cost of the Public Trustee's management of their damages. In delivering his judgment in this case, Justice Carter found the inclusion of such a fee to be compelling by reason of its foreseeability as a loss occasioned directly by the defendant's wrong.[2] His Honour was persuaded by the reasoning found in the decision of Justice Zelling in *Campbell v Nangle*:[3]

> 'If you injure a plaintiff so badly that he has permanent brain damage and he can neither manage the resulting fund for himself nor make any decision with regard to its management, then it is foreseeable that there is going to have to be a manager to do that for him and, with a large fund of this kind, a skilled manager whose fees must be paid for.'

Justice Zelling distinguished between charges for 'work done on investments' and what he referred to as 'domestic or housekeeping functions'. He did not allow the first category as damages on the basis that any person with such a large award would require such services. This situation prevailed in Queensland for many years.

But with the commencement on 1 July 2000 of the *Guardianship and Administration Act* 2000, increasing competition among a growing number of trustee companies, and new financial services reform legislation affecting fee disclosure, the full cost of financial management has become apparent to lawyers working in this area.

Questions now arose about the true cost of management of the funds and whether plaintiffs with impaired capacity were being properly compensated for their loss. These issues had been the subject of generally conflicting judicial determination in other jurisdictions,[4] and some early skirmishes in Queensland, but it was not until the High Court's decision in *Willet v Futcher*[5] in 2005 that we were given some answers.

WILLET v FUTCHER

The settlement in *Willett v Futcher* was sanctioned by Justice Byrne of the Supreme Court of Queensland, and a further order was made that the defendant pay a sum by way of damages in respect of 'reasonable management fees'. The parties subsequently disputed what constituted 'reasonable management fees'. The Court directed that the Public Trustee be joined as a party to the proceedings and that the Public Advocate have leave to intervene. The Court had to consider whether the cost to the plaintiff of obtaining suitable investment advice and other ancillary charges ought to be borne by the defendant as an aspect of the damages 'in respect of reasonable management fees'. Whereas the plaintiff argued that the cost was a need that had been created as a direct consequence of the defendant's wrongdoing, the defendant argued that the cost to the plaintiff was not compensable, being rather a means of maximising the settlement sum.

Extensive evidence was given about the total management fees, which had been divided into a number of categories. After careful consideration of these categories, Justice White concluded that investment advice and associated charges are a separate item of charge and are 'in principle' not recoverable. She allowed the sum of $180,000 in respect of two categories only, described as the 'establishment fee' and a 'discretionary portfolio management fee'. Four other categories were disallowed.[6]

The Queensland Court of Appeal decided that the cost to the plaintiff of a trustee company carrying out its obligations as a trustee in managing the fees was not 'a cost in the expenditure of which the plaintiff has, or had at any time, a choice; it is incurred because the defendant's negligence caused the incapacity requiring the appointment of a trustee and because a trustee has those obligations at law'.[7] Although the Court appeared to have rejected the reasoning of Justice White at first instance, it was content to allow the sum awarded to stand without awarding any further amount for ancillary charges.

On appeal to the High Court,[8] the central issue was 'what kinds of costs of managing the damages awarded to a person incapable of managing his or her own affairs, whose incapacity was caused by the defendant's negligence, are to be allowed in assessing the damages allowed to that person'.[9] >>

The High Court considered the three most relevant statutes: the *Public Trustee Act* 1978 (Qld), the *Guardianship and Administration Act* 2000 and the *Trustee Companies Act* 1968. The Court commented that:

> 'close attention must be paid to the relevant provisions of these statutes (or their equivalent in other jurisdictions) by those who propound a compromise of litigation brought on behalf of a person who is not of full capacity, as well as by the court which is asked to approve such a compromise and those who are later to be involved in the administration of any resulting trust fund.'[10]

The Court held that the answer to the central question was that no distinction of the kind made at first instance should be drawn. An amount should be allowed for remuneration and expenditures properly charged or incurred by the administrator of the fund during its intended life. It also held that the services provided by an administrator must first be identified, and that this task would require close attention to the relevant statutory limitations on those charges. The Court found that damages should be calculated 'so as to place the plaintiff, so far as possible, in the position he or she would have been in had the tort not been committed',[11] stating that the position of the incapacitated plaintiff should not be compared with that of a plaintiff with capacity and a lump sum to invest.

> 'In the ordinary course a person who is not injured will not have to husband a large sum of money over a long period of time in such a way as to ensure an even income stream but the complete exhaustion of the fund at the end of the period.'[12]

The final result was that the appeal was allowed and the matter remitted back to the Court of Appeal to assess the damages.

IMPLICATIONS OF *WILLET v FUTCHER*

There is now no longer any differentiation between management fees and investment fees. If a fund for which management fees are reasonably charged is necessary, and investment advice required, because of the negligence of the defendant (that is, where the plaintiff is under an incapacity, either as a minor or as an adult, and the existence of funds, the need to manage them, and the need to receive investment advice for the funds stem from the 'damages' paid by a defendant as a result of their negligence), then the investment fees are to be considered as reasonable management fees.

It is likely that this decision by the High Court will result in an increase in amounts sought, and allowed as, damages for fund management in personal injury claims involving mental incapacity.

REASONABLE MANAGEMENT FEES

Having established that investment fees are now indeed considered reasonable management fees, we need to consider the different types of investment fees that exist for different types of investments.

The financial industry is complex, with a variety of solutions, strategies and products available to meet a client's needs. The assessment of the fees that are charged can be as complex as the solutions recommended. Often, there are a number of service providers involved in the delivery of the financial product or service who need to be renumerated for their contribution to the end product.

TYPES OF FEES AND CHARGES

Establishment fee

A once-only establishment or contribution fee is charged to establish strategies, products and solutions to meet the client's needs. This fee is calculated either as a flat fee or as a percentage of the assets to be invested.

Ongoing management fees

These generally cover three main areas – custody, advice and decision-making:

- 'Custody' includes the administration, monitoring, reporting and maintenance of all the investments managed.
- 'Advice' covers strategic and investment advice including regular reviews, research of individual investments (existing and future recommendations), and restructuring financial affairs according to individual circumstances.
- 'Decision-making' includes implementing financial decisions on behalf of the client, taking into account the client's particular needs and the trustee's obligations under the relevant legislation.[13]

The types of fees charged under this head by administrators/trustee companies vary, and could be one or a combination of the following examples (this list is not exhaustive):

- a flat fee depending on the value of the asset being managed;
- a flat fee depending on the support and living circumstances of the client whose affairs are being managed;
- a flat fee depending on the number of transactions in a given period of time;
- a flat percentage of the assets being administered; and
- a tiered-fee scale with a reducing percentage fee calculated on the value of the assets being administered.

Third-party management fees

These fees will vary depending on the professional services available to or provided by the administrator and the individual investment decisions that are made by that administrator. Fees described as 'ongoing management fees' could be outsourced to third-party providers if the appointed administrator does not have the professional resources internally. Some examples of this include financial planning advice, custody and administration of investment assets, and direct property management. The fees and methods of charging for these services will vary but could be on similar lines as those charges discussed above.

The most common third-party fees are management expense ratios (MER), which are charged by fund managers, and brokerage fees, which are charged when purchasing direct investments such as Australian shares.

MERs are usually charged as a percentage of the asset being managed. These fees are charged before the return on the

investment is paid to the investor and, therefore, an investor rarely sees the extent of this cost. The level of these fees will vary depending on the asset class (generally a lesser fee for cash than for more complex asset classes like international shares) and whether the administrator is able to access retail or wholesale funds on behalf of the client.

Direct shares and listed property trusts are other forms of investment open to administrators and are ones for which brokerage fees may be charged. The costs generally associated with making such investments are the initial brokerage and any ongoing brokerage incurred when changes are made to the portfolio. The level of brokerage will vary depending on the broker, and could be expressed as a flat-dollar amount per trade, a percentage of the value of the trade or a combination of both.

PRESENT VALUE CALCULATIONS

Personal injury lawyers are obviously concerned with understanding what a client will pay generally and, in particular, the present value of management fees over the anticipated time of management. It is therefore important to consider the assumptions that are made when calculating these fees. The fact that they are discounted by 5% is generally accepted, but other assumptions that will have a significant impact on the final calculation will vary in each individual case.

'Life expectancy', or the term of the fund's management, will influence the final calculation and is an area that will require agreement between the parties. It may be that the funds were not intended to compensate the injured party for their entire life expectancy, but were created with reference to another timeframe. This should be taken into account when considering terms of management. In the case of money being paid to a minor, the term of the management may be the number of years until age 18, especially if the individual is likely to have capacity for financial matters when they reach his or her majority.

The tax-deductible nature of some of the above fees may benefit some plaintiffs. The deductibility of these fees varies depending on the source of the charge and the nature of the activity. The tax system is constantly being reviewed in Australia with changing rates of taxation, increasing tax brackets, and changing definitions regarding tax deductibility of expenses and other rebate entitlements. The difficulty with taking the tax deductibility into account when calculating a present value is that the funds are usually calculated over long periods of time, making it a difficult benefit to quantify.

CONCLUSION

Management fees is a complex area, and determining what is 'reasonable' may be difficult, as different fund managers may describe their fees in different ways.

- Lawyers need to be aware of a number of things:
- The different trustee options available.
- Depending on the option, the different types of fees that will apply.
- The full range of fees, not just those charged by the particular trustee company, but also those charged by other financial professionals and product-providers involved in the management or provision of financial services to the client.
- Where a product or services are provided, or if a trustee makes decisions on behalf of a client, fees need to be disclosed. ■

Notes: **1** [1988] 2 Qd R 674. **2** See Note 1 above, at 677. **3** (1985 – 1986) 40 SASR 161. **4** See *Treonne Wholesale Meats Pty Ltd v Shaheen* (1988) 12 NSWLR 522; and *Government Insurance Office of New South Wales v Rosniak* (1992) 27 NSWLR 655. **5** [2005] HCA 47. **6** At para 35; C Advisory portfolio management fee; D Fund manager fee; E Initial brokerage fee; and F Ongoing brokerage fee. **7** *Willett & Anor v Futcher* [2004] QCA 30 at para 24. **8** Above Note 1. **9** Above Note 1 at para 49. **10** Above Note 5 at para 13. **11** Above Note 5 at para 51. **12** Above Note 5 at para 51. **13** *Trusts Act* 1973, *Guardianship and Administration Act* 2000.

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