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Parliamentary Joint Committee on Corporations and Financial Services

Second Supplementary Submission by Omni Bridgeway Limited

Inquiry into Litigation Funding and Regulation of the Class Action System

6 November 2020

Purpose of Submission

Omni Bridgeway Limited (**Omni Bridgeway**) lodged a submission with the Parliamentary Joint Committee on Corporations and Financial Services (**Committee**) on 17 June 2020 and a Supplementary Submission on 8 July 2020 in relation to its inquiry into litigation funding and regulation of the class action system.

The purpose of this Supplementary submission is to address four issues:

- the public interest in the Australian Financial Services Licence (**AFSL**) requirements being extended to all forms of funding, not just funding of class actions;
- the need for clarity on the application of the Managed Investment Scheme (**MIS**) framework to group costs orders;
- the risks associated with delay tactics and challenges from defendants in respect to maintaining registers in accordance with the MIS framework, despite the Australian Securities & Investments Commission (**ASIC**) 'no action' position on non-compliance with maintaining registers; and
- the changing face of shareholder class actions.

(1) The need for the AFSL requirements to be extended to all forms of funding, not just funding of class actions.

Omni Bridgeway's first submission to the PJC made the following recommendation in response to question 5 (The Australian financial services regulatory regime and its application to litigation funding):

> *"Introduce a licensing regime for litigation funders that would include minimum onshore capital adequacy requirements, disclosure obligations and reporting standards – complementing existing regulations related to conflicts…"*

Consistent with that submission, the *Corporations Amendment (Litigation Funding) Regulations 2020* (Litigation Funding Regulations) should be extended to litigation funding of all forms of litigation, not just *Litigation Funding Schemes* (i.e. the term used in the Litigation Funding Regulations and is limited to multi-party litigation).

Omni Bridgeway views the role played by litigation funders in both single and multi-party litigation as essentially the same. In Australia, the funder provides funding, adverse cost indemnification and case management.

What should be expected of the funder is also essentially the same in both types of litigation. They should have adequate capital, comprehensive disclosure, conflicts management and reporting processes. These are important to protect the interests of the claimants who are receiving funding and also the interests of the defendants in the litigation. Without an adequately capitalised funder, a defendant may be unable to recover their costs if they successfully defend the matter. Likewise, if the funder has insufficient financial resources, they may not be in a position to fund the matter to completion with highly disadvantageous consequences for the claimants.

A key difference between single party and multi-party litigation funding is that the majority of single party recipients of funding are likely to be considered wholesale within the meaning of the *Corporations Act 2001 (Cth)* (Corporations Act), whereas the majority of participants in a multi-party action are likely to be retail, notwithstanding that there are often also wholesale participants. In the context of shareholder class actions, the wholesale participants generally make up the majority of the total claim by value.

This distinction should not matter. When providing financial products or services to wholesale clients, there is still a requirement to hold an AFSL under the *Corporations Act*. Further, this distinction should not be drawn now that Litigation Funding Schemes are considered a financial product and Insolvency Litigation Funding Schemes and Litigation Funding Arrangements are also considered to be financial products, albeit exempt financial products.

As a practical matter, a multi-party action may result in a series of single party actions. The mechanics of a multi-party action involve a single representative who brings an action in their own right and as a representative of the group members to determine common questions. Once these have been answered, unless the proceedings are settled, it becomes a series of single party actions to recover amounts in reliance on the determination made in respect of the common questions. Does this mean that upon determination of the common questions a multi-party action ceases to be a Litigation Funding Scheme and is no longer subject to the requirements of the *Corporations Act*. Omni Bridgeway submits this would be a perverse outcome.

The distinction between litigation funding that requires an AFSL and funding that does not require an AFSL appears to be an artificial one, and one that is likely to confuse consumers. A claimant who is receiving litigation funding may not be in a position to draw a distinction between licensed activities and unregulated activities, making the reasonable assumption that all of the activities of the relevant funder are subject to the AFSL regime and the conduct rules in the *Corporations Act*, when they are not.

It is reasonable for a person to assume that misconduct in respect of one form of litigation financing will have ramifications for the funder in all of their activities, which appears not to be the case where there are unregulated or exempt activities on the one hand and regulated activities on the other.

Omni Bridgeway reiterates its previous submissions to this Committee and public statements that it has made in support of a licensing regime for litigation funding. However, we would recommend that it applies uniformly to all aspects of the litigation financing industry. We submit the distinction between operating a MIS in the form of a Litigation Funding Scheme, as opposed to providing a financial product in respect of a Litigation Funding Arrangement, is an appropriate distinction between multi-party litigation funding and single party funding.

(2) The need for clarity on application of the Managed Investment Scheme (MIS) framework to group costs orders.

What is a GCO?

Group Costs Orders (GCO) were recently introduced into the *Supreme Court Act 1986 (Vic)* (Supreme Court Act) by operation of the *Justice Legislation Miscellaneous Amendments Act 2020 (No. 22 of 2020) (Vic)* (Amendments).

The Amendments to the *Supreme Court Act* include section 33ZDA, which allows the court to make an order for the calculation of legal costs payable to a law practice based on a percentage of the amount of any award or settlement that may be recovered in the Group Proceeding. The liability for payment of legal costs must be shared amongst the representative and the group members. Further, if there is an order for security for costs or an adverse costs order against the representative, the law practice is liable to make these payments.

Group Proceeding is defined in section 33A as being a proceeding commenced under Part 4A of the *Supreme Court Act*. A Group Proceeding involves 7 or more persons against the same person, where the claims of all of those persons are in respect of, or arise out of, the same, similar or related circumstances and the claims give rise to a substantial common question of law or fact. Such proceedings may be commenced by one or more of those persons representing all of them. Group Proceedings are often referred to as 'class actions', notwithstanding that in most jurisdictions in Australia they are characterised as representative or group proceedings in the relevant state or federal legislation.

Legal costs payable to a law practice that are calculated based on a percentage of the amount of any award or settlement are often described as a contingency fee.

Section 183 of the *Legal Profession Uniform Law (Victoria)* (Uniform Law) prohibits contingency fees. However, s.33ZDA (4) provides that "This section has effect despite anything to the contrary in the Legal Profession Uniform Law (Victoria)…".

Omni Bridgeway believes that there are three issues with the legislative structure of the GCO regime as follows:

(a) the requirement for the making of a GCO that the Court be satisfied such an order is appropriate or necessary to ensure that justice is done in the proceedings suffers from the same failings that the High Court considered in *BMW Australia v Brewster; Westpac Banking Corporation v Lenthall [2019] HCA 45,* finding that the Court did not have power to make the common fund order in that case, and could be difficult to meet;

(b) when determining the terms of any GCO, the factors the Court can take into account may be limited to the legal costs otherwise payable to the law practice seeking the order, so that matters such as interest accruing on those costs , security for costs and adverse costs potentially payable by the law practice could not be taken into account - with the potential result being that law practices will not seek such orders; and

(c) all GCO arrangements may constitute a managed investment scheme - with the result that law practices cannot work under such an order without complying with the requirements of the managed investment scheme regime.

The first two matters will have to await determination by the Courts, but Omni Bridgeway believes the third should be considered by the Committee. If in fact the GCO regime does not presently create a managed investment scheme under the definition in section 9 of the Corporations Act, then the Committee should consider recommending that the regulations be amended so as to include the GCO regime into the managed investment scheme regime upon the grounds set out hereunder.

Similarity with group proceedings funded by a third-party funder

The GCO regime effectively makes the law firm, the funder of the group proceedings. The law firm carries the legal costs and disbursements and is liable for any security for costs or adverse costs order. The law firm receives a percentage of the recoveries as the legal costs, contingent on there being a recovery.

Are proceedings conducted under a GCO, a managed investment scheme?

Absent any applicable exemption (discussed below), proceedings conducted under a GCO appear to satisfy the requirements of a MIS under section 9 of the *Corporations Act*, in the context of the current law as determined by the *Brookfield Multiplex Case* . The table below sets out the common features:

Legislative Provision	Litigation Funding Scheme (LFS)	Group Costs Order	Commentary
s.9 *Corporations Act* definition of a Managed Investments Scheme:			
(a)(i) people contribute money or monies worth:	The *Brookfield Multiplex Case* majority decision determined that the assignment of an interest in the resolution sum constitutes monies worth.	The liability for payment of the GCO is shared among the plaintiff and the group members.	The assumption of a liability, albeit a contingent liability, appears to be a contribution of monies worth using the logic in the *Brookfield Multiplex Case*. In our opinion the economic effect of either a LFS or a GCO is the same, as a participant has contributed part of

Legislative Provision	Litigation Funding Scheme (LFS)	Group Costs Order	Commentary
			their award or settlement amount, if successful, to the entity that meets the costs (either the third party funder or the lawyer).
(a)(ii) the contributions are pooled or used in a common enterprise:	The majority decision in the *Brookfield Multiplex* concluded this was the case.	The language of ss.33ZDA(1)(b) *Supreme Court Act* 1986 (Vic) states that "*the liability for payment of the legal costs must be shared among the plaintiff and all group members*."	Shared liability is, in our view, an example of a common enterprise, if not a pooling of resources.
(a)(iii) the members do not have day to day control over the operations of the scheme.	The representative plaintiff has day to day control over the provision of instructions to the lawyers, with some oversight or contractual rights to control the scheme residing with the Funder/Operator. The group members have no control over the operations of the scheme. ASIC and the relevant court also have a supervisory role in respect of the LFS.	The representative plaintiff has day to day control over the provision of instructions to the lawyers. The group members have no day to day control over the operations of the scheme. The Victorian Supreme Court has a supervisory role in respect of the GCO, and depending on whether they are concluded to be a non-exempt MIS, ASIC may have a supervisory role	The group members in a LFS or a GCO do not have day to day control of the conduct of the scheme.

Are proceedings conducted under a GCO exempt from being a MIS?

Litigation funding, in the context of a representative or group action, is now treated as a financial product under the *Corporations Act*, and it is regulated as a Managed Investment Scheme (MIS) as a result of the removal of an exemption formerly contained in the *Corporations Regulations 2001* with the making of the *Litigation Funding Regulations*.

Omni Bridgeway is of the view that there is a lack of clarity around how a GCO is treated under the Corporations Act, which is important to resolve given a GCO achieves substantially the same commercial outcome for a representative and/or group members as a Litigation Funding Scheme.

Omni Bridgeway submits that *ASIC Corporations (Conditional Costs Schemes) Instrument 2020/38* (Conditional Costs Instrument), which was released prior to the introduction of the Litigation Funding Regulations, creates ambiguity as to whether a GCO in the Victorian Supreme Court is exempt. Under the *Conditional Costs Instrument* the exemption from registration as a MIS is limited to a *conditional costs agreement* as defined in section 181 of the Uniform Law.

The critical question therefore is whether a GCO is a conditional costs agreement as defined.

Under s181 of the Uniform Law:

1. A costs agreement (a ***conditional costs agreement***) may provide that the payment of some or all of the legal costs is conditional on the successful outcome of the matter to which those costs relate.
2. A conditional costs agreement must—
   (a) be in writing and in plain language; and
   (b) set out the circumstances that constitute the successful outcome of the matter to which it relates.
3. A conditional costs agreement must—
   (a) be signed by the client; and
   (b) include a statement that the client has been informed of the client's rights to seek independent legal advice before entering into the agreement.
4. A conditional costs agreement must contain a cooling-off period of not less than 5 clear business days during which the client, by written notice, may terminate the agreement, but this requirement does not apply where the agreement is made between law practices only.
5. If a client terminates a conditional costs agreement within the cooling-off period, the law practice—
   (a) may recover only those legal costs in respect of legal services performed for the client before that termination that were performed on the instructions of the client and with the client's knowledge that the legal services would be performed during that period; and
   (b) in particular, may not recover any uplift fee.

Section 182 allows for the payment of an uplift fee in respect of a conditional costs agreement in certain circumstances.

As referred to above, section 183 prohibits contingency fees. But GCO's, which are in effect contingency fee agreements, are not prohibited by virtue of section 183 because s.33ZDA (4) of the *Supreme Court Act* provides that the section has effect despite anything to the contrary in the *Uniform Law*. However, this does not make GCO's conditional costs agreements, which they need to be in order to be exempt from being a MIS.

There is doubt as to whether a GCO is a conditional costs agreement because:

1. a conditional costs agreement under the Uniform Law cannot be a contingency fee agreement, because section 183 provides that contingency fees are prohibited;
2. for the same reason, the "legal costs" referred to in s181 cannot be read as a reference to legal costs determined by reference to the amount of any award or settlement , since legal costs cannot be determined in that manner under the Uniform Law (because of s183);
3. section 182, which provides that a conditional costs agreement may provide for an uplift fee not exceeding 25% of the legal costs, reinforces the above interpretation of legal costs . It would be odd if "legal costs" could be read as including a contingency fee with the outcome that there would be an uplift percentage on a percentage (if permitted); and
4. a conditional costs agreement needs to be signed by the client and each group member will not be signing the GCO.

If a GCO is not exempt under the *Conditional Costs Instrument*, on the basis that a GCO is not a conditional costs agreement, then a GCO would be at risk of being a MIS (see the analysis above). If it is a MIS, then a law practice that operates under a GCO is required to hold an AFSL with a Responsible Entity authorisation and comply with the MIS provisions. An alternative method for compliance with the *Corporations Act* in these circumstances is for a law practice to appoint a third-party Responsible Entity to operate the MIS on their behalf where they offer a GCO. For completeness, we note that under s.258 of the *Uniform Law* (which remains undisturbed by the amendments to the *Supreme Court Act*) a law practice is not permitted to promote or operate a MIS.

If a GCO is exempt within the meaning of the *Conditional Costs Instrument*, then we have the anomalous position that a third party funded group proceeding is treated as a MIS, but a law firm funded group proceeding is not.

We suggest that the Committee recommend the regulations be amended so as to expressly include the GCO regime as part of the managed investment scheme regime.

(3) Despite the comfort provided by ASIC on the member register issue, there is a risk of challenges by defendants delaying class action outcomes.

Terms used in this section that are defined in the *ASIC Corporations (Litigation Funding Schemes) Instrument 2020/787* (LFS Instrument) have the same meaning.

ASIC has published a *No Action Position* on 21 August 2020 (No Action Position) in respect of Responsible Entities of certain registered Litigation Funding Schemes and member registers that are required to be kept under sections 168 and 169 of the *Corporations Act*. ASIC have acknowledged that it is not reasonably practical for Responsible Entities of registered Litigation Funding Schemes that have one or more passive members (open litigation funding schemes) to comply with these requirements in respect of those members. ASIC have also acknowledged in the *No Action Position* that it is unable to exempt or modify these provisions under the *Corporations Act*, as they do not have the power to grant relief in respect of Part 2C, as they can with other Parts of the *Corporations Act*, including Chapters 5C and 7.

The problem with a no action approach, whether published by ASIC or as provided privately to applicants, is that they have no binding effect on third parties and can also be withdrawn by ASIC at any point in time. As a result, a third party may be able to litigate non-compliance with a provision of the *Corporations Act*, including any failure to maintain a register in accordance with s.168 that contains the information required under s.169 of the *Corporations Act*.

Omni Bridgeway is concerned that it will not be able to maintain a register of passive general members of a Litigation Funding Scheme, as those persons will not necessarily be known to Omni Bridgeway, yet based on the *LFS Instrument* they will be deemed members of the scheme. This is likely to be the case even in a securities class action where there is a register of holders of the relevant securities maintained by the defendant company. It is not open to assume that the funder will be able to obtain access to that register, given the interpretation of ss.177(1A) of the *Corporations Act* in *IMF (Australia) Limited v Sons of Gwalia Limited (Administrator Appointed) (2005)]143 FCR 274*. In any case, the register usually does not reveal the underlying beneficiary where nominee companies are used.

We do not agree that passive general members are members of an open litigation funding scheme. Whilst these passive general members are group members of the class action, they have not signed a litigation funding agreement with a funder or signed a retainer with a law practice that is conducting the legal proceedings. Accordingly, they have not contributed any money or money's worth as consideration, as required under the definition of a managed investment scheme in section 9 of the Corporations Act.

We are not aware of any other form of MIS where it is possible to be a deemed member of that MIS. It is our contention that a person is required to take some form of positive step in order to become a member of the MIS, whether that is by signing an application form, acquiring a unit or units in the secondary market or having their adviser or investment platform do the same on their behalf. We raised this concern with ASIC prior to the publication of the LFS Instrument.

If the position adopted by ASIC in the *LFS Instrument* in respect of passive general members was reversed and it was made clear that general members of a Litigation Funding Scheme are only those persons who have signed a funding agreement, signed a retainer with the law practice or who have otherwise agreed to contribute "money or money's worth", the need for the No Action Position would fall away. These general members would be capable of being identified and included in any registers required to be kept pursuant to sections 168 and 169 of the *Corporations Act*.

The ability of a third party to litigate non-compliance with the *Corporations Act* by the Funder or scheme operator means there could be delay in the determination of the main questions of fact or law that are the substance of the class action (i.e. delaying payments to claimants), without any change to the final determination. Such disputes are also likely to increase the costs to all parties, with no benefit to any of them.

We request that the Committee consider recommending the Government withdraw the aspects of the *LFS Instrument* that create the concept of a passive general member or alternatively to publish regulations that address the difficulties associated with sections 168 and 169 of the *Corporations Act*.

(4) The changing face of shareholder class actions

We wish to draw the Committee's attention to the outcome of the second shareholder class action that has been decided by the courts, rather than by way of settlement. In *Crowley v Worley Limited [2020] FCA 1522* handed down on 22 October 2020, the Federal Court found that Worley had not engaged in misleading and deceptive conduct and had not breached the continuous disclosure regime.

In the first shareholder class action decided by the court (*TPT Patrol Pty Limited as Trustee for Amies Superannuation Fund v Myer Holdings Limited [2019] FCA 1747*), handed down on 24 October 2019, the Federal Court found that although Myer had breached the continuous disclosure regime, there was no loss or damage that flowed from this failure.

Two other shareholder continuous disclosure cases in the Federal Court, which were not conducted as representative or class actions, (*Masters v Lombe (liquidator): in the Matter of Babcock & Brown Limited (in liq) [2009] FCA 1720* and *Grant – Taylor v Babcock & Brown Limited (in liq) [2016] 245 FCR 402* (Full Federal Court dismissing appeal from first instance decision finding in favour of the defendant)) resulted in a loss by the share purchaser plaintiffs.

These cases, all of which were determined against the shareholder, serve to dispel any suggestion that shareholder class actions are low risk and put the commission received by funders for assuming the risks into perspective. In its publication Allens Insights (26 October 2020), law firm Allens commented that:

(a) "Australia's first (Myer) and second (Worley) shareholder class action judgments highlight the significant risk that applicants, and the litigation funders that support them, take when pursuing such claims to trial. Neither judgment sounded in any award of damages for shareholders"; and

(b) "The failure of both the Worley and Myer cases (the only shareholder class actions to proceed to judgment) may cause plaintiff firms (and the funders that support them) to think twice about bringing shareholder class actions based on alleged misleading earnings guidance. It may also cause defendants facing such claims to be more willing to take them to trial".

The recent cases are also relevant to a question of whether to make changes to the continuous disclosure regime, which is a matter that has attracted debate during the COVID-19 pandemic. While this issue is not the focus of the Committee's current inquiry, it is important that any future consideration of a permanent change to the continuous disclosure regime should examine, among other issues, the way in which the Courts are interpreting and applying the legislation.

Other recent events should also be taken into account by the Inquiry in considering any reform in this area. We do not consider that there has ever been a flood of shareholder class actions and the total number ever instituted remains modest, especially compared with the number of listed companies.

Nevertheless, it is our submission that the following will have a dampening effect on shareholder class actions:

- the cases referred to above;
- the recent High Court cases of BMW Australia v Brewster; Westpac Banking Corporation v Lenthall [2019] HCA 45 finding that the Court had no power to make common fund orders, at least at an early stage of the proceeding;
- the recent challenges to the power of courts to make common fund orders at any stage of the proceedings, with the NSW Court of Appeal and the Full Federal Court both declining to consider the issue on a declaratory basis (Brewster v BMW Australia Limited [2020] NSWCA 272 and Davaria Pty Limited v 7-Eleven Stores Pty Ltd [2020] FCAFC 183);
- the increasingly proactive approach by the Court in supervising and approving settlements; and

- the recent regulatory changes with respect to litigation funding.

These recent developments are clearly important in the consideration of any balanced and reasonable reform in this area.

Please do not hesitate to contact me if further information is required or you have any queries on the material raised in this supplementary submission.

Yours sincerely

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Managing Director and CEO