

# Parliamentary Joint Committee on Corporations and Financial Services

Supplementary Submission by Omni Bridgeway Limited

Inquiry into Litigation Funding and Regulation of the Class Action  
System

8 July 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 in relation to its inquiry into litigation funding and regulation of the class action system.

We believe it may assist the Committee's deliberations to provide a comprehensive response to the Menzies Research Centre's submission ('MRC', submission 66) which contains substantial misunderstandings and misinformation concerning the Inquiry's terms of reference. This is particularly the case in that the MRC purports to use Omni Bridgeway to illustrate a raft of ill-conceived and mischievous assertions.

## Menzies Research Centre Submission: Claims and Responses

Omni Bridgeway has analysed the MRC's submission and identified a range of issues where we believe the record should be set straight as the Committee works through the important issues raised in this inquiry.

We set these out below as claims made by the MRC and Omni Bridgeway's responses:

*Claim #1: 'Over the last ten years alone, 355 class actions were filed in Australia. This represents 56% of the total number of class actions filed in the regime's 28-year history'. (page 6)*

**Response:** Litigation funding only became fully permitted for class actions after the High Court decision in *Fostif*<sup>1</sup> in 2006 and as such, the capacity to fund class actions was restricted for the first 14 years of the 28-year history. In quoting this study, the MRC deliberately omits to mention that Professor Morabito bifurcates his analysis on this basis to reflect the very material change in legal footing that occurred following this case.

The proposition that the MRC presents as a revelation is statistically unremarkable once the proper context is understood. It should also be acknowledged that a significant number of the 355 class actions to which the MRC refers were in respect of the same cause of action.

*Claim #2: 'In FY19, some 59 class actions were commenced. In the period from 1 July 2019 to 31 January 2020, at least 30 class actions have been filed'. (page 6)*

**Response:** Of the class actions filed in FY19, 19 were shareholder class actions<sup>2</sup>, and in the period to 31 January 2020, 3 are shareholder class actions<sup>3</sup>. This is actually a material decline in the specific area of class actions that the MRC seems to be most concerned about.

It should also be acknowledged that a number of the class actions in the periods to which the MRC refers were in respect of the same cause of action.

*Claim #3: Chart (Figure 2) showing the change in five categories of class action over the first 13.5 years of the period in which class actions have been permitted in Australia versus the second 13.5 year period. (page 8)*

**Response:** For the same reason as Claim #1 – the decision in *Fostif* – what is presented by MRC as revelation is statistically unremarkable.

Before *Fostif*, class actions were usually run on a 'no win no fee' basis. After *Fostif*, the High Court permitted litigation funding for "access to justice" reasons, and as such shareholders were able to more easily access funding to pursue their rights. Undoubtedly, the period after 2006 has also seen a growing awareness of shareholder rights as well as corporate misbehaviour as shown through nationally prominent inquiries such as the Hayne Royal Commission.

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<sup>1</sup> *Campbells Cash and Carry Pty Limited v Fostif Pty Limited* [2006] HCA 41

<sup>2</sup> V Morabito, "An Evidence-Based Approach to Class Action Reform in Australia: Shareholder class actions in Australia – myths v facts", November 2019.

<sup>3</sup> Commonwealth of Australia 2020, Parliamentary debates: House of Representatives: Hansard, 13 May 2020, pp. 3344

*Claim #4: ‘...courts have held that litigation funding should be regulated variously as a managed investment scheme or financial product’, reflecting on the subsequent decision by the then Government to exempt litigation funders to hold an Australian Financial Services Licence (AFSL). (page 9)*

**Response:** It is simply incorrect to say that courts have held that litigation funding should be regulated as a managed investment scheme or financial product. The courts in *Multiplex* (where ultimately only 2 of the 4 judges who considered the matter came to this conclusion) held that the litigation funding scheme in that case was a MIS, but there were reasons it may be exempted. They didn’t comment on how litigation funders should be regulated. The High Court in *Chameleon*<sup>4</sup> found that litigation funding agreements were not financial products.

The grant of the exemption to hold an AFSL and register class actions as a MIS was in response to the decision in *Multiplex*. Prior to *Multiplex*, litigation funders were required to comply with their contractual obligations to clients and to the Courts. After *Multiplex*, litigation funders had additional obligations with the Conflict of Interest regulations<sup>5</sup>.

*Claim #5: ‘These developments [court approval of litigation funding and exempting litigation funding from the requirement to hold an AFSL] have effectively converted what was intended to be a mechanism to allow groups of people to resolve their legal claims efficiently and cost effectively into an industry which is focused on delivering financial returns to investors in litigation’. (page 9)*

**Response:** This tendentious assertion ignores the fundamental point that litigation is highly expensive and the groups they refer to can’t afford to finance the pursuit of their rights. The class action mechanism is neutered if the action cannot be funded. Litigation funding solves that problem and, in Omni Bridgeway’s case, has assisted over 300,000 people access justice.

The alternative is that the people within these groups can’t pursue their rights, and the parties that break the law get away with causing them damage. The various protections built into the court process ensure that the focus remains on achieving a fair and reasonable outcome for the group members.

*Claim #6: ‘An investor presentation by Omni Bridgeway from May 2020 reveals that, as of 30 April 2020, ‘multi-party’ matters comprise 27% of its global litigation portfolio. However, the same presentation also reveals that multi-party matters comprise 70% of its Australian investment portfolio’. (page 10)*

**Response:** This is another purported ‘gotcha’ statistic presented by the MRC which either deliberately or ignorantly mischaracterises the position. The 27% statistic would only be meaningful if class actions were funded by Omni Bridgeway around the globe. The reality is that US investments represent 50% of Omni Bridgeway’s portfolio, but we do not fund class actions in the US. No class actions are funded in Asia. There is also a broader range of case types in which funders are able to invest in other countries but not currently in Australia, for example, Que tam/whistle-blower cases and portfolios of contingency cases for law firms.

Overall, the company’s class action involvement is reducing.

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<sup>4</sup> *International Litigation Partners Pte Ltd v Chameleon Mining NL (Receivers and Managers Appointed)* [2012] HCA 45

<sup>5</sup> Reg 7.6.01AB(4) Corporations Amendment Regulations 2001

*Claim #7: Purported analysis sourced from Herbert Smith Freehills (HSF) claiming that from 2016 to 2019 the average percentage of settlement proceeds going to class members decreased from 59 to 39 per cent, with corresponding increases in the proportions received by funders and plaintiff lawyers. (pages 12 to 13)*

**Response:** The source data cannot be verified. Requests have been made by Omni Bridgeway of HSF on 16 and 22 June and on 5 July to provide the underlying data, but it has not been provided. The referenced data is inconsistent with the empirical research by Professor Morabito, the ALRC, Omni Bridgeway's own experience and data from Maurice Blackburn.

There is no disclosure that Herbert Smith Freehills has a substantial practice in advising large corporates on defending class actions.

*Claim #8: The ALRC.....reported that in actions settled between 2013 and 2018 class members in actions without a third-party litigation funder received a median return of 85%. When a funder was involved that amount fell to just 51%'. (page 13)*

**Response:** It is a statement of the obvious that when any asset is funded, the financier needs to be paid. The key question is could the action have been commenced at all without funding? The answer in most cases will be 'no'.

Unstated by the MRC is that the 'unfunded' matters cited by the ALRC were undertaken on a 'no win no fee' basis. This means that if the case is lost, the applicant is liable to be declared bankrupt and the defendant would not be able recover adverse costs. Is the MRC claiming the public interest is more effectively served in this scenario?

*Claim #9: 'If class members are forced to surrender fifty per cent or more of the compensation they receive to litigation funders and lawyers, any success they may achieve is illusory. Class members cannot begin to replace a home or business lost in a fire or flood if they receive half or less of the replacement cost'. (page 13)*

**Response:** This statement is risible. The key question is could the action have been commenced at all without funding? The alternative for the vast majority of claimants is to receive nothing in recompense.

As the MRC must know, very few complaints are made by claimants about litigation funding, the majority of whom recognise that they would have no redress without funding and who receive substantial protection from the existing court system.

*Claim #10: '...litigation funders in Australia are generating ROIC returns seventeen (17) times more than investors in ASX 200 stocks and more than ten (10) times the average global hedge fund and private equity performance'. (page 14)*

**Response:** At best, this is an extraordinarily superficial and naïve comment on the part of the MRC.

Any observer with financial markets training understands this is comparing 'apples with zebras'. There is simply no comparison between a ROIC and net returns from various indexes. Among the many problems with this comparison include:

- Duration – a litigation investment average three years, but maybe many more years in duration (the Wivenhoe matter being funded by Omni Bridgeway is 8 years and counting), whereas returns are annual.
- ROIC is calculated before costs of running a business; Omni Bridgeway's net return after overheads is 9%.
- Liquidity – litigation investments are highly illiquid; this is completely different to investment in ASX stocks or in private equity investments.
- Loss risk – the loss risk on the ASX 200 index is negligible, whereas litigation funding loss risk is 170% (i.e. the quantum of case funding plus adverse costs, assuming only one represented defendant).
- Investment quantum – the size of the investment at the outset is uncertain as litigation investments are uncapped and open-ended and adverse cost exposure is uncapped.
- Control – litigation investments provide limited control to the funder (i.e. the claimant controls the case), in contrast to securities and private equity investing.

*Claim #11: The high returns and low risk of litigation funding make this a tantalising investment class...the litigation funding industry seeks to justify these returns by arguing they are necessary given the risks associated with funding...However...the success rate for third-party funded class actions in Australia is between 87% and 94%'. (page 15)*

**Response:** As with the previous claim, this statement is at best wholly naïve.

There is no scenario in which litigation can be described as a 'low risk' investment activity. The funder makes its assessment before a class action is commenced, defence filed or interlocutory processes, with no expert evidence and lay witnesses untested – in other words, when the risk is highest.

As has repeatedly stated by courts over the years, it is completely invalid to assess the prospects of success from a position of hindsight, as the MRC does here. For instance, Justice Murphy in *Murray Goulburn* when discussing the considerations for assessing the reasonableness of a funding commission stated: "The litigation risks of providing funding in the proceeding.....is a critical factor and the assessment must avoid the risk of hindsight bias and recognise that the funder took on those risks at the commencement of the proceeding".

The returns cannot be viewed in isolation and need to take into account losses on matters and the costs of running the business.

*Claim #12: The litigation funding industry is unregulated and there are no statutory or other criteria for determining how litigation funding agreements operates or a funders remuneration should be determined'. (page 18)*

**Response:** The MRC is fundamentally wrong in this sweeping assertion. The litigation funding industry is currently regulated and operates by reference to:

- ASIC Class Order 248 – Conflicts of Interest
- Oversight by Court and legal practitioners
- Federal Court Class Action Practice Note (and practice notes in other courts)

- Overarching obligations to the Federal and various State Courts
- Common law obligations
- Contractual obligations to clients

These various forms of oversight set criteria for how litigations funders:

- Communicate with group members
- Can become involved with the litigation
- Deal with evidence and other information before the Court (Harman undertakings)
- Are remunerated, as well as the reasonableness of the legal costs

*Claim #13: 'As a result, the approach taken by the court in relation to the funders remuneration is haphazard and undertaken without regard to principles of corporate finance or benchmarks for risk adjusted rates of return'. (page 18)*

**Response:** Given the MRC's own misunderstanding of corporate finance and the basic principles of investment, this is an interesting assertion. It is also disrespectful of, and patronising towards, Australia's senior courts.

Contrary to the MRC's assertion, in assessing the reasonableness of a proposed settlement which involves a commission payment to a litigation funder, the courts take into account the specific risks and costs associated with the particular case, informed by a confidential merits assessment made by the plaintiff's counsel, with the use of a barrister contradictor (independent party to the funder) if deemed necessary. It is done by specialist judges with extensive class action experience, with the acknowledgement that hindsight assessment of risk is inappropriate, as the decision to accept the risk is made the time the investment is made.

A court's assessment is multi-factored and informed. This is abundantly clear from the empirical research undertaken by Professor Morabito, whose work has been accepted by Australia's courts as independent and definitive. As noted above, any comparison with 'benchmarks' (see Claim #10, above) ignores the idiosyncratic aspects of funding litigation.

*Claim #14: 'For their part, both the litigation funder and the plaintiffs' lawyer representing the class is hopelessly conflicted and unlikely to do anything to jeopardise the approval or delay receiving their often significant remuneration. Unless a class member is willing to appear at the approval hearing with independent lawyers at their own expense to oppose or question the settlement costs or remuneration, nobody will be independently representing class members'. (page 18)*

**Response:** This assertion by the MRC is littered with errors and shows a complete lack of understanding of class action proceedings in Australia, including:

- Litigation funders and lawyers are bound to address any conflicts and ultimately the focus of the approval hearing is on what is in the best interests of the group members.
- Plaintiff lawyers have been paid by the funder throughout the litigation and as such do not have a significant financial interest in the outcome.

- There is a split profession in Australia where the senior counsel is at the independent bar and they represent the class. No in-principle settlement will be reached without the senior counsel being prepared to sign off on it as being fair and reasonable in their opinion.
- The judge will decide whether the fees and commission are “fair and reasonable” based on the evidence presented to them.
- The judge will hear from class members without representation and can appoint counsel to assist and act in the best interests of group members at the cost of the funder.
- The funder’s commission is set out in the Litigation Funding Agreement signed by class members before they become a class member (or in the case of common fund orders as ordered by the court with prior notice to group members) and the budget for legal fees and disbursements will be provided by the lawyers.
- Class members have the right to opt out of a class action if they consider their interests are best served in their own proceedings.

*Claim #15: Description and analysis of Murray Goulburn, a class action funded by Omni Bridgeway. (page 19)*

**Response:** The MRC repeats its error of assessing the prospects of success from a position of hindsight, rather than when the risk was undertaken. As Justice Murphy stated in Murray Goulburn when discussing the considerations for assessing the reasonableness of a funding commission: “The litigation risks of providing funding in the proceeding.....is a critical factor and the assessment must avoid the risk of hindsight bias and recognise that the funder took on those risks at the commencement of the proceeding”. Murray Goulburn demonstrates the role the judge plays, assisted with the benefit of case-specific confidential material, in assessing the reasonableness of the funder’s fee.

The MRC compounds its flawed analysis by ‘cherry-picking’ a particular case. Any balanced consideration of returns needs to be done on a portfolio basis (as Justice Beach noted in Sirtex), after taking into account the overheads of running a business. Not surprisingly, the MRC decided not to cherry pick the bank fees case funded by Omni Bridgeway, where our loss was around \$25 million.

*Claim #16: Description and analysis of the Per-and-Poly-Fluoroalkyl Substances (PFAS) cases, class actions funded by Omni Bridgeway. (pages 20-21)*

**Response:** The ‘large number’ of claimant objections cited by the MRC were in fact less than 3% of group members, who objected to various issues including the settlement amount, legal fees and the commission. The obvious corollary to this proposition is that 97% of claimants did not object.

The MRC again seeks to benchmark the ROIC against other asset classes, but conveniently ignores that:

- The investment by Omni Bridgeway was for 4.5 years, but the matter could have gone on for years more with the matter potentially going to the High Court.
- The investment was illiquid, as compared to the range of other investment classes.



- Omni Bridgeway's ultimate commitment of around \$30 million was more than originally estimated, as was the potential adverse costs exposure of around another \$25 million.
- This was a risky investment, involving untested areas of the law and complex scientific evidence. There was significant uncertainty around the quantum of damages until just before trial and the assessed quantum following receipt of expert evidence was lower than Omni Bridgeway's initial estimate.
- Returns need to be considered on a portfolio basis, or after overheads of running the business.
- Omni Bridgeway's return on at risk capital was 0.4x.

MRC refers to the return to class members being less than the loss of the value of their properties as a consequence of the contamination. This is simply wrong. Experts gave opinions on loss, and applying these opinions, the settlements were 97%, 103% and 109% for Williamtown, Oakey and Katherine of the likely claimable diminution in the group members' property value. Consequently, the Judge noted that the settlements achieved "can fairly be described as excellent".<sup>6</sup>

*Claim #17: Common Fund Orders (CFOs) are magnifying claim sizes. (pages 22-23)*

**Response:** In this confused discussion, the MRC has sought to conflate CFOs with the growth in Omni Bridgeway's estimated portfolio value (EPV) as stated in our ASX announcements.

CFOs in Australia were first permitted by the Money Max decision in October 2016. Omni Bridgeway has funded five Australian class actions utilising a CFO with a total EPV of \$173 million. Of these five cases, the CFO has been withdrawn in three of them.

The actual reasons for the growth in Omni Bridgeway's EPV relate to:

- Launch of third-party funds in 2017.
- Expansion of geographic footprint to Canada in 2016, Asia in 2017 and UK in 2018.
- Growth in investments in the US and other overseas jurisdictions.

Relevantly to the MRC's assertion, Omni Bridgeway has not actually funded a shareholder class action in Australia in over 16 months.

*Claim #18: Omni Bridgeway's Funds 2 and 3 which invest in 'Australia and the region'. (page 24)*

**Response:** Contrary to the MRC's characterisation, this Fund is not predominantly an Australian fund. This Fund invests into Australia, Canada, Asia and EMEA (Europe, Middle East and Africa) with the geographic split of investments being, 37%, 17%, 20% and 26%, respectively<sup>7</sup>.

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<sup>6</sup> *Smith v Commonwealth of Australia (No 2)* [2020] FCA 837, para 68

<sup>7</sup> Based on Estimated Portfolio Value.



*Claim #19: Judges do not have the experience and training in corporate finance to properly assess risks and returns, and the settlement process more broadly. ‘...courts are left as unwitting accomplices in what is unconscionable conduct on the part of the litigation funding industry’. (page 28)*

**Response:** The response to this assertion as per Claim #13. In this reference, the MRC further compounds its extraordinary characterisation of Australia’s courts as ignorant, unsophisticated patsies of litigation funders.

*Claim #20: ‘The vices that attend the litigation funding industry.....are well documented’. This includes a further claim that ‘the litigation funder controls the proceedings.....’. (pages 28 and 29)*

**Response:** In referring to ‘vices’ the MRC confirms that its work on litigation funding is an exercise in hyperbole and literary flourish rather than a serious attempt at objectively analysing industry issues. The MRC ignores the more balanced findings of previous inquiries and reviews undertaken by the Productivity Commission, Treasury, Australian Law Reform Commission and Victorian Law Reform Commission.

On the issue of control, the MRC’s suggestion is wrongheaded. It is incorrect to suggest that funders control proceedings. Lead plaintiffs in class actions have ultimate say, and instruct their own lawyers. On settlement, the court has the ultimate say.

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

Yours sincerely



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