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BREWSTER AND BEYOND: AN UPDATE ON LITIGATION FUNDING

BRIEFING PAPER
SEPTEMBER 2020

Recent developments in litigation funding

Following the High Court's decision in *BMW Australia Ltd v Brewster; Westpac Banking Corporation v Lenthall*[1] (***Brewster***) in December 2019 and a number of subsequent Federal Court decisions in recent months, we are presently in a place where the issue of how a court is likely to treat the commission sought by a litigation funder in a class action is a question without a clear answer.

Whether a funding equalisation order or an order substantively equivalent to a common fund order might be made, and the question of the court's power effectively to vary contractually agreed rates of commission, are issues on which different judges have expressed different views.

Recent changes at Commonwealth level have introduced a measure of regulation to litigation funding; however, these changes do not help to clarify how courts will (or should) address the question of a funder's entitlements at the conclusion of a class action proceeding.

In Victoria, legislation has been enacted creating a path for plaintiff firms who seek to fund proceedings on a 'contingency fee' basis to do so.

In this briefing note we explore these recent developments in more detail.

Background

Key to the substantial growth of litigation funding in Australia over the last decade has been its development in parallel with the development of Australia's class action regimes.

The basis for third-party litigation funding

In its pivotal 2006 decision in *Campbell's Cash and Carry Pty Ltd v Fostif Pty Ltd* (***Fostif***),[2] the High Court ruled that the commercial funding arrangements in that case were not contrary to public policy. The majority of the High Court accepted that a class action proceeding funded (and substantially controlled) by a third-party litigation funder was not contrary to public policy and did not amount to an abuse of process.

This decision, which effectively gave a green light to third-party litigation funding, paved the way for the substantial growth of litigation funding in Australia.

An increasing number of Australian class actions are backed by off-shore litigation funders. Equally, a number of Australian-based litigation funders are increasingly pursuing opportunities in overseas markets. However, and notwithstanding the current uncertainty in relation to third-party litigation funding, we expect that large litigation funders will continue to operate in Australia, although continuing uncertainty and regulatory developments may require such funders to make some adjustments to their business models. Australia's "opt-out" class actions procedure is one factor that is likely to ensure continuing interest of third-party litigation funders in Australian proceedings, when compared to some other jurisdictions.

> "The solution to th[e] problem (if there is one) does not lie in treating actions financially supported by third parties differently from other actions."
>
> ***FOSTIF* — GUMMOW, HAYNE & CRENNAN JJ**

Subsequent developments

A further significant development in litigation funding occurred in 2016 when the Full Federal Court held in *Money Max Int Pty Ltd v QBE Insurance Group Ltd*[3] (***Money Max***) that "common fund orders" could be made under s 33ZF of the *Federal Court of Australia Act*.

S 33ZF(1) OF THE *FEDERAL COURT OF AUSTRALIA ACT*

the Court may, of its own motion or on application by a party or a group member, make any order the Court thinks appropriate or necessary to ensure that justice is done in the proceeding

The text of s 33ZF appears above. It is a provision which is replicated in the various State class action regimes.

However, even at the time of the decision in *Money Max*, differences of opinion regarding common fund orders were acknowledged, with the Full Federal Court noting Justice Gordon's observations in *Modtech Engineering Pty Ltd v*

[1] (2019) 374 ALR 627.

[2] (2006) 229 CLR 386.

[3] (2016) 245 FCR 191.

GPT Management Holdings Ltd[4] that it was difficult to conceive of circumstances in which a common fund order would be appropriate.[5]

Justice Gordon went on to form part of the 5:2 majority in *Brewster* (discussed below) which held that common fund orders were not within the Court's power under s 33ZF of the *Federal Court of Australia Act* (or its State equivalents).

Common fund orders vs funding equalisation orders

Prior to *Brewster*, a common fund order was an interlocutory order, usually made pre-trial, requiring class members to contribute to the litigation funder a percentage of any settlement or judgment in their favour, regardless of whether the class member had entered into a funding agreement with the funder.

An alternative mechanism for distributing a funder's commission amongst class members is a funding equalisation order.

A funding equalisation order is an order, made at the conclusion of a proceeding, which provides for deductions to be made from the amounts payable to group members who did not enter funding agreements in order to spread the burden of the funding commission across the class members, and thereby ensure that group members receive proportionately equal shares of the settlement or judgment.

Funding equalisation orders may result in lower, and sometimes materially lower, returns to litigation funders when compared with common fund orders because the pool from which the commission is drawn in a funding equalisation order scenario is limited by the number of class members who have entered funding agreements.

In contrast, the pool from which the commission is drawn in a common fund order scenario is not limited by the number of class members who have entered funding agreements.

High Court decision in *Brewster*

As reported in our earlier update (available here), in *Brewster*, the High Court considered whether common fund orders were within the power conferred by s 33ZF of the *Federal Court of Australia Act* (and the NSW equivalent) to make "*any order this Court thinks appropriate or necessary to ensure that justice is done in the proceeding*". A 5:2 majority held that they were not.

> "[A]n application for a [common fund order] is centrally concerned to determine whether the proceeding is viable at all .... That is a question outside the concerns of ss 33ZF and 183."
>
> ***BREWSTER* — KIEFEL CJ, BELL & KEANE JJ**

The plurality judgment of Kiefel CJ, Bell and Keane JJ held that the authority conferred by s 33ZF of the *Federal Court Act* and its NSW equivalent is concerned with *how* an action proceeds, rather than with whether the action *can* proceed. The provisions do not authorise making "*an order in favour of a third party with a view to encouraging it to support the pursuit of the proceeding*".[6]

The plurality also observed that there are provisions in the legislation dealing with the making of orders at the conclusion of a proceeding, and expressed the view that instead to rely on s 33ZF (or its State equivalents) as the basis for a common fund order is to re-write the legislation.[7]

Decisions post *Brewster*

In the months since *Brewster*, a number of decisions have been handed down regarding litigation funding issues in a settlement approval context. What emerges from these decisions is a set of cases which, although seeking to apply the principles of the High Court's decision in *Brewster*, is not necessarily consistent.[8]

Most of these decisions accept that courts have power to make an order equivalent to a common fund order at the settlement approval stage under s 33V(2) of the *Federal Court of Australia Act* (and its State equivalents). There is some uncertainty, however, about when it will be appropriate to make an order equivalent to a common fund order (now described by some judges as an "expense

[4] [2013] FCA 626.

[5] (2016) 245 FCR 191 at [141].

[6] (2019) 374 ALR 627 at [47].

[7] Ibid at [68]-[70].

[8] See, for example, *Clime Capital Ltd v UGL Pty Ltd* [2020] FCA 66 (***Clime Capital***); *McKay Super Solutions Pty Ltd v Bellamy's Australia Ltd (No 3)* [2020] FCA 461 (***McKay***); *Cantor v Audi Australia Pty Limited (No 5)* [2020] FCA 637 (***Cantor***); *Fisher v Vocus Group Ltd (No 2)* [2020] FCA 579 (***Fisher***); *Pearson v Queensland* [2020] FCA 619; *Uren v RMBL Investments Ltd (No 2)* [2020] FCA 647 (***Uren***); *Webster v Murray Goulburn Co-Operative Co Ltd (No 4)* [2020] FCA 1053 (***Webster***).

sharing order" [9]) as opposed to a funding equalisation order.

S 33V OF THE *FEDERAL COURT OF AUSTRALIA ACT*

(1) A representative proceeding may not be settled or discontinued without the approval of the Court.

(2) If the Court gives such an approval, it may make such orders as are just with respect to the distribution of any money paid under a settlement or paid into the Court.

Section 33V(2)

Unlike s 33ZF which was considered in *Brewster*, s 33V(2) is not a "gap-filling" power. It is a broad discretionary power granted to the Court specifically in relation to the distribution of money paid under a settlement or paid into Court, which can only be exercised at the time of settlement approval when the expenses associated with the proceeding can be accurately calculated.[10]

Accordingly, the argument goes, the concerns identified by the High Court in *Brewster* are not present when making an order at settlement approval stage pursuant to s 33V(2).

This line of thought appears to be generally accepted in the Federal Court[11] – and, in fact, is reflected in paragraph 15.4 of the Federal Court's Class Actions Practice Note, updated shortly after the decision in *Brewster* – although it has not yet been tested before the Full Court of the Federal Court, or the High Court.

Relevant factors

Perhaps the most controversial aspect of the current uncertainty regarding litigation funding orders is the question of when it is appropriate to make an order akin to a common fund order as opposed to a funding equalisation order (accepting that an order akin to a common fund order *can* be made at the settlement approval stage of a class action pursuant to s 33V(2)).

In order to make an order under s 33V(2), the Court must consider that the order is "just".[12]

The following factors relevant to that question were noted by Murphy J in *Webster v Murray Goulburn Co-operative Co Ltd (No 4)*, where his Honour made an expense sharing order at the settlement approval stage:

- It is fair and equitable to make an expense sharing order where the litigation funder took on the costs and risks of the case in return for the percentage funding commission expressed in the agreement between the funder and the plaintiff, and the litigation would not have been brought without funding.[13]
- A percentage-based expense sharing order is a just, fair and transparent method of ensuring that all class members who benefit from the settlement pay the same pro rata share of litigation funding expenses.[14]
- Whether an expense sharing order or a funding equalisation order is "just" is a case-specific enquiry, but where, as in *Webster*, only the representative plaintiff has entered into a funding agreement, a funding equalisation order would not be just or fair.[15] In the circumstances of *Webster*, if a funding equalisation order were made, the class members would receive close to a 'free-ride', and the funder would receive a return which went nowhere near a commercially realistic return for the costs paid and risks borne when funding the litigation.[16]
- The funder funded the litigation prior to the decision in *Brewster*, when it was reasonably thought that common fund orders under s 33ZF were permissible.[17]
- No class member had objected when informed through the Notice of Proposed Settlement that the plaintiff would seek a common fund order.[18]

On the other hand, in *Fisher v Vocus Group Ltd (No 2)*, Moshinsky J opined that the majority of the High Court in *Brewster* "indicated strong reasons favouring the making of a funding equalisation order over a common fund order", although the High Court did not express a "concluded view that there is no power under s 33V to make a common fund order".[19]

In concluding that a funding equalisation order was appropriate in the circumstances of that case, Moshinsky J considered the following factors:[20]

[9] See eg, *Webster* at [110].

[10] *Uren* at [51].

[11] *Clime Capital* at [7]; *McKay*; *Fisher* at [72]; *Webster* at [110]-[111]. An exception is the decision of Foster J in *Cantor*.

[12] *Uren* at [51].

[13] *Webster* at [114].

[14] Ibid at [116].

[15] Ibid at [117].

[16] Ibid at [119].

[17] Ibid at [121].

[18] Ibid at [122].

[19] *Fisher* at [72]-[73].

[20] Ibid at [74].

- An order akin to a common fund order would impose an additional cost on group members by requiring more money to be paid to the funder than would otherwise be the case.
- A funding equalisation order would take, as its starting point, the actual cost incurred in funding the litigation.
- A funding equalisation order was sufficient to ensure that all class members who received the benefit of the litigation contributed to the cost of the proceeding and, so, adequately dealt with the problem of 'free-riding'.
- A funding equalisation order awards the funder the commission to which they are contractually entitled under contracts with funded class members.

Level of funding commission

The question of whether courts have power, at the settlement approval stage, to vary the contractual arrangements between litigation funders and class members concerning the level of commission payable to the funder also remains open, adding another layer of uncertainty to the landscape.[21]

On the one hand, some authority suggests that the courts lack power to alter the contractual promises of group members except where, because of individual circumstances, there is an established legal or equitable basis to interfere.[22] On the other hand, some authority suggests that s 33V(2) provides a statutory basis for overriding the contractual bargain through the power that section confers to make such orders as are "just".[23]

The matter was considered recently in *Endeavour River Pty Ltd v MG Responsible Entity Ltd (No 2)*,[24] where Murphy J formed a preliminary view that the contractually agreed level of funding commission (a rate of 30% or 35% depending on the size of the class member's claim) was too high.[25] The funder initially proposed to challenge this, but stepped back from doing so. Ultimately, the funder accepted a lower rate of 25%, and on this basis Murphy J approved the settlement as fair and reasonable.[26]

[21] See, eg, *Earglow Pty Ltd v Newcrest Mining Ltd* [2016] FCA 1433 at [133]-[158]; *Blairgowrie Trading Ltd v Allco Finance Group Ltd (Recs & Mgrs Apptd) (In Liq) (No 3)* (2017) 343 ALR 476 at [101]; *Mitic v OZ Minerals Ltd (No 2)* [2017] FCA 409 at [27]-[29]; cf *Liverpool City Council v McGraw-Hill Financial, Inc* [2018] FCA 1289 at [47].

[22] *Liverpool City Council v McGraw-Hill Financial, Inc* [2018] FCA 1289 at [47].

[23] *Blairgowrie Trading Ltd v Allco Finance Group Ltd (Recs & Mgrs Apptd) (In Liq) (No 3)* (2017) 343 ALR 476 at [101].

[24] [2020] FCA 968.

[25] Ibid at [3].

[26] Ibid at [26], [47].

Legislative change

Writing judicially, Justice Beach of the Federal Court has called for legislative intervention in respect of the Court's powers in relation to litigation funding, noting that post-*Brewster*, trial judges *"now have less flexibility to deal with commission rates"* and urging that the issue be addressed sooner rather than later.[27]

There have in recent months been changes to the regulatory framework for litigation funding at both Commonwealth level and in Victoria, although in neither case do these changes respond to the issue of the court's power in relation to the commission rates of third-party funders.

Federal developments

On 22 May 2020, the federal Treasurer announced that regulations would be introduced requiring litigation funders to hold an Australian Financial Services Licence and to comply with the regulatory requirements applying to managed investment schemes.

> "[the regulations] will also require greater transparency around the operations of litigation funders in Australia"
>
> **THE HON JOSH FRYDENBERG, TREASURER, 22 MAY 2020**

The *Corporations Amendment (Litigation Funding) Regulations 2020* (Cth) were introduced in July 2020, to apply to new funding arrangements from 22 August 2020.

ASIC has now confirmed (through the ASIC Corporations (Litigation Funding Schemes) Instrument 2020/787) that litigation funders will be relieved from certain of the managed investment scheme obligations, including by not having to give a product disclosure statement to 'passive' members of open litigation funding schemes.

How the complex regulatory framework for managed investment schemes will be applied in practice is yet to be seen, and will likely raise issues which may require modification to the regulations, clarification from the courts and/or further guidance from ASIC.

It is also likely that the regulations will impose new burdens on litigation funders, and may impede some new funded class actions in at least the short term.

[27] *McKay* at [34].

There is potential for further legislative intervention at the federal level. The Parliamentary Joint Committee on Corporations and Financial Services is currently conducting an inquiry into litigation funding and the regulation of the class action industry and is due to report by 7 December 2020.

Victorian developments

On 18 June 2020, the Victorian Parliament passed the *Justice Legislation Miscellaneous Amendments Act 2019* (Vic). The Act authorises the Victorian Supreme Court to make "group costs orders" permitting plaintiff lawyers in class actions to receive a contingency fee.

A contingency fee is a fee structure whereby the plaintiff's solicitors receive a percentage of the amount of any award or settlement that may be recovered in a proceeding. Such a fee structure may allow plaintiff firms to 'fund' class actions without the involvement of a third-party funder.

Victoria is the first jurisdiction in Australia to permit this to occur and the Victorian regime is now out of step with the federal regime, which may lead to forum-shopping. On one view, the legislation may incentivise some plaintiff firms to commence proceedings in the Supreme Court of Victoria, rather in than the Federal Court, with lawyers acting on a contingency basis and eschewing the services of third-party litigation funders. On the other hand, not all plaintiff firms will have the resources to run class actions on this basis. It has also been said that the introduction in Victoria of contingency fees may also incentivise plaintiff firms to commence class actions regarding issues which have typically received less attention from third-party litigation funders. It may also encourage plaintiff firms to commence 'open' class actions in relation to the same subject matter for which a closed class action has already been brought following a book build (discussed below).

A return to book building

Prior to the High Court's decision in *Brewster*, the Federal Court had exhorted plaintiff law firms and funders to avoid the "wasted" time, costs and expense of book building.[28]

Brewster, however, will likely lead funders to redouble on book building, as funders seek to sign up more group members in order to better position themselves for a potential funding equalisation order.

Book building, of course, is likely to be easier for the larger funders who have greater ability to expend the resources involved in identifying and signing up group members. Larger funders are likely to have established relationships with institutional shareholders, and it may be easier for these funders to book build for shareholder class actions than for other types of class action claims. However, the application of managed investment scheme regulations to litigation funders, including the anti-hawking and product disclosure provisions of the *Corporations Act*, is likely to make book building more difficult for even the larger funders.

Quite what effect this will have more broadly is presently unclear. It is possible that a return to book building will see smaller actions fail to launch, or take longer to launch, because they are less viable commercially. Funders who already tended to book build may be less impacted, but still may need to make adjustments to their funding model.

It is also possible that there will be an increase in the multiplicity of proceedings, as smaller funders (or possibly, in Victoria, law firms on a contingency fee basis) commence actions to supplement closed class actions that are funded by a larger funder following the book build process.

Final observations

Recent months have been a time of significant development in the litigation funding landscape in Australia.

As the issues discussed above show, there is considerable judicial focus on the role of litigation funders at present, and this is also reflected in debates ongoing in the community more broadly about the role of litigation funding and the right approach to the regulatory framework and need for oversight.

We expect these issues to continue to evolve in the coming months. We offer a few further observations below by way of conclusion, based on our view of the current environment.

Substantial uncertainty as to the approach courts will take to the question of funders' entitlements makes it difficult in specific cases to assess the returns that may ultimately be available to class members, and therefore to understand what a 'fair and reasonable' settlement might look like in a particular proceeding.

This presents obvious challenges for class action respondents, who may now find it difficult to determine an appropriate quantum on settlement discussions in the context of uncertainty in relation to the commission that will be awarded to a litigation funder. Coupled with a possible rise in multiplicitous actions, respondents will be interested to see how the issues discussed in this paper develop.

[28] As referred to in *Webster* at [120].

It seems possible, perhaps probable, that, without further parliamentary intervention, funding-related issues will make their way to the High Court again. A further decision could shift the legal landscape yet again.

The changing regulatory framework, together with the prospect of increased emphasis on book building post-*Brewster*, has the potential to increase the market share of larger funders. This may in turn drive up funding costs.

This leads back to the issue of courts' role in scrutinising funders and funding commissions, and the importance of courts' powers to ensure the regime operates with integrity, efficiency and fairness.

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