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Profitable Justice: Aligning Third-Party Financing of Litigation with the Normative Functions of the Canadian Judicial System

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55 CBLJ 34 - PROFITABLE JUSTICE: ALIGNING THIRD-PARTY FINANCING OF LITIGATION WITH THE NORMATIVE FUNCTIONS OF THE CANADIAN JUDICIAL SYSTEM

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This article analyzes the appropriate regulatory framework for third-party litigation financing with a view to balancing the interests of access to justice, protection of vulnerable parties and freedom of contract. The author develops a set of principles relevant to the analysis including the sophistication of the parties and the character of the litigation. Because of the broad range of litigation financing and the diversity of claims for which financing may be sought, the author argues in favour of judicial oversight, combined with a principles-based legislative framework focused on mandatory disclosure for both the financier and the litigant receiving the funding. Such an approach would promote fair dealing between the financier and the litigant seeking the funding as well as effective and efficient dispute resolution between the plaintiff and the defendant.

I. INTRODUCTION

The historic, common law doctrines of champerty and maintenance have imposed strict limits on the ability of third-parties to acquire a pecuniary interest in the proceeds of litigation or provide financial support to litigants. [1] As a result both contingency fee structures and litigation loans had the potential to be held voidable at common law. However, recent growth in and greater appreciation of the financial barriers to litigation have prompted a relaxation of the doctrines and a vibrant debate on the appropriate regulatory framework for the litigation financing industry. [2]

As this debate progresses, it should be kept in mind that any regulatory intervention must reflect the broad differences among

litigants seeking to access litigation financing, including relatively unsophisticated personal injury claimants, class counsel, and commercial litigants. Regulatory intervention must also provide sufficient flexibility for parties to use litigation financing to shift the expenses, adverse costs and risks associated with litigation. This article identifies the parameters of such a regulatory regime with a view to balancing the interests of access to justice, protection of vulnerable parties and freedom of contract, and providing a basis for further discussion on the appropriate regulation of this rapidly evolving industry. The author argues that judicial oversight, combined with a principles-based framework of legislation centred around disclosure is best suited to mitigate the potential power and information imbalances between the financier and the litigant. A disclosure-based model could also provide both the plaintiff and the defendant with the information to engage efficiently in settlement negotiations with knowledge of the other's capacity to maintain the litigation.

The discussion proceeds as follows. Part II defines the concept of third-party litigation financing, distinguishing its various forms and the circumstances in which third-party litigation financing may be utilized. This discussion underscores the need for a contextual approach to regulation, which considers the sophistication of the parties and the nature of the litigation. Part III describes the historical development of exceptions to the common law bar against champerty and maintenance and the growth of third-party financing of litigation. Part IV outlines the types of litigation that may be receptive to third-party financing, the types of lending products commonly used and current approaches to regulating these instruments. Finally, Part V develops a set of principles aimed at promoting fair dealing, effective dispute resolution and the standardization of litigation financing agreements offered to meet the needs and interests of the range of litigants and financiers. Part VI concludes.

II. DEFINING THE SCOPE OF THIRD-PARTY LITIGATION FINANCING

Litigation financing may be defined based on the character of the recipient, the scope of coverage or the terms of repayment. Potential regulatory responses must be carefully tailored to address each of these features. In particular, regulatory regimes have to be structured to provide sufficient proactive protection for unsophis

Page 36

ticated litigants but also to provide the flexibility necessary for sophisticated parties to contract freely and appropriately shift their litigation risk.

Recipients of litigation financing can be divided based on their sophistication and whether they have commenced the litigation personally or on behalf of a broader class. Personal actions frequently involve unsophisticated plaintiffs for whom third-party litigation financing offers the only means by which the action can be brought. In such circumstances, the doctrines that place limits on freedom of contract may apply, particularly if there is a gross asymmetry of bargaining power between the lender and the plaintiff. Where unsophisticated parties lack the capacity to negotiate effectively with a larger and more sophisticated financier, doctrines that limit freedom of contract allow the court to review whether the contract was fair and reasonable. [3] However, when sophisticated commercial parties are involved, the Supreme Court has emphasized that there exists "a very strong public interest in the enforcement of contracts." [4] The common law principles limiting freedom of contract thus provide a starting point for legislative reform designed to provide enhanced safeguards for unsophisticated litigants.

Actions may also be commenced by sophisticated commercial plaintiffs who have the capacity and resources to negotiate the terms of the litigation financing agreement. In these circumstances, litigation finance is comparable to other forms of commercial lending.

Finally, financing may be procured by representative plaintiffs in class actions. Third-party financing of class actions presents particular challenges because courts must assume a more immediate, supervisory role to ensure the terms of the agreement are fair to all members of the class. These challenges are more fully explored in the other papers in this symposium that focus on class actions and ethics.[5]

Another factor by which litigation financing arrangements can be distinguished is the form and content of the litigation finance

Page 37

contract. For example, an agreement may cover some or all of the legal fees or may be limited to covering disbursements and other discrete payment events. Similarly, third-party litigation financing agreements can serve as a form of insurance designed to indemnify the plaintiff for some or all of the costs associated with an adverse judgment. Yet another variation occurs when a law firm operating on a contingency fee basis obtains third-party financing to support its practice by shifting to the litigation funder a portion of the risk associated with an unsuccessful action. [6]

Finally, litigation financing agreements can be distinguished based on the character of repayment. Many agreements utilize a no-recourse contingency repayment structure whereby the plaintiff is only required to repay the principal amount if they are successful in their claim. This repayment may be structured either as a percentage of the total award or the principal plus interest accrued, with the proceeds serving as security for the loan.

In light of the different degrees of party sophistication in these various financing scenarios, an appropriate balance must be struck between the protection of vulnerable parties, allowing plaintiffs to use third-party litigation financing to assert their legal rights, and the potentially harmful effects of allowing third parties to accrue windfall profits from another party's litigation. As a consequence of the multiple forms of litigation financing contracts, any potential regulatory response will necessarily touch on multiple related areas of law including commercial lending and financing, the lawyer's professional duties to their clients, and contract law.

One of the purported benefits of third-party financing of litigation is that it eliminates the need for lawyers to use intra-firm partnerships to aggregate sufficient resources to finance a large action. When adequately financed by a third-party, the number of lawyers involved in a case may therefore be reduced to an efficient level. [7] On the other hand, the literature identifies three adverse consequences of the increased use of non-recourse third-party litigation financing. Firstly, collaborative synergies between the affiliated firms may be eliminated. [8] Second, since litigation counsel is no longer using its own resources to finance the litigation, the incentives for counsel to manage disbursement costs may be

limited. [9] Finally, no-recourse loans may limit the incentive for counsel to screen unmeritorious litigation. [10] These adverse effects may, in turn, result in increased case volume and duration as plaintiffs are more able to pursue a wider variety of cases.

These purported adverse consequences might, however, be the products of a shift in the locus of power resulting from enhanced financing of plaintiff counsel. As such they may reflect the proper market equilibrium which should exist but is stymied by the traditional under-financing of plaintiffs. In fashioning a regulatory response, legislators must be careful not to label what is a market correction associated with the equitable financing of plaintiffs as an adverse effect of litigation financing.

III. THE CANADIAN CONTEXT: CHAMPERTY, MAINTENANCE AND THE SHIFT FROM ABSOLUTE PROHIBITION TO JUDICIAL SUPERVISION

The doctrine of maintenance refers to the provision of financial support for a litigant who would not otherwise be able to commence litigation. Maintenance is illegal when the financier uses the financing to incite litigation, which would not otherwise have been contemplated or desired by the plaintiff. [11] Champerty is a subset of the doctrine of maintenance which arises when the financier acquires a pecuniary interest in the proceeds of the litigation. [12]

A principal purpose of the doctrines of champerty and maintenance is to protect the administration of justice from abuse by non-interested parties. The law of champerty and maintenance was first codified in England in 1305. [13] This law was originally developed to bar the practice of assigning doubtful or fraudulent claims to Royal officials, nobles or persons of influence who were more likely to receive favorable treatment than the actual claimant. [14] As such, champerty and maintenance protect the

integrity of the civil litigation system and opposing parties from intermeddling by third parties whose interests may not be aligned with those of the plaintiff.

In 1897, the Champerty Act was enacted by the Ontario legislature based on provisions found in English law. Although the English statute which provided a model for the Champerty Act has since been repealed, the Ontario legislation provides that "all champertous agreements are forbidden, and invalid." [15]

Agreements which are champertous or constitute prohibited maintenance are statutorily invalid and give the defendant to the champertous litigation a cause of action in tort at common law. [16] This cause of action allows the defendant (as claimant) to recover costs associated with the champertous litigation. [17] Generally, the defendant cannot normally move to stay the champertous litigation since the maintainer is not a party to the action before the courts and champerty and maintenance are not defences to the merits of the claim. [18] This indicates that the mischief underpinning the doctrines is the potential for an improper relationship between the plaintiff and the financier, rather than the merits of the litigation between the plaintiff and the defendant.

A central feature of champertous agreements is the "improper motive" of the financier. [19] Thus, the mere fact that a third-party is financing a lawsuit is necessary but not sufficient to invalidate a litigation financing agreement. Courts have described the requisite improper motive as attempts at "officious intermeddling" and "stirring up strife." [20] In particular, the Ontario Court of Appeal in *McIntyre* held that third-party litigation financing agreements, such as contingency fee arrangements, are not *per se* champertous; rather the court must inquire whether the fee structure is unreasonable or unfair in order to determine if the financier has an improper motive. [21]

In a similar vein, the Privy Council stated in 1860 that champerty and maintenance "must be something *against good policy and justice* and to the constitution of which a bad motive in

the same sense is necessary." Thus, the doctrines of champerty and maintenance do not exist to regulate litigation financing *per se*; rather they target conduct which tends to commence, aggravate or otherwise enlarge litigation.

Based on this distinction, courts have recognized a range of exceptions to the doctrines of champerty and maintenance. These exceptions include charity and compassion, legitimate common interest in the litigation, and pre-existing commercial interest or legitimate business interest. [22] In addition, legislative exceptions were created for the assignment of debt, accounts receivable and related choses in actions, and for contingency fee arrangements by lawyers. [23]

Although there is a substantial degree of overlap in the jurisprudence on exceptions to the doctrines of champerty and maintenance in the context of personal actions, legitimate business interests, and class actions, courts have adopted differing approaches in each context. [24] These approaches reflect, in part, the different litigation products available and the identity of the plaintiffs.

IV. ACTIONS FINANCED BY THIRD PARTIES

This section provides an overview of the different contexts in which litigation finance can be used. It emphasizes how both the similarities and differences between these structures affect the appropriate regulatory strategy. Litigation financing in the context of individual actions and class actions is considered. Finally, litigation financing for plaintiffs is contrasted with the long-standing use of insurance by defendants to limit their litigation exposure and ensure more predictable expenses.

1. Individual Actions

Individual actions can utilize a variety of litigation financing products. These include financing for legal costs and disbursements which may be structured as a loan or contingency fee payable only upon a successful judgment, insurance against

Page 41

adverse costs awards and disbursements, and contingency fee arrangements with the plaintiff's counsel, which may or may not be underwritten by a third-party litigation financing company that will require repayment of the loan irrespective of the success of the claim.

When litigation financing is provided on a contingency fee basis, lenders will be required to charge higher interest rates than could otherwise be offered for regular commercial financing. These higher rates account for both the litigation risk and the increased costs associated with conducting an in depth analysis of a particular claim. Courts have affirmed the need for litigation financing agreements to be commercially reasonable in relation to the nature of the plaintiff's claim. For instance, in *Giuliani v. Halton (Regional Municipality)* , the Ontario Superior Court determined that a 51% interest rate charged on a litigation loan was unconscionable, usurious and would bring the administration of justice into disrepute by condoning predatory lending practices. [25] The court focused on whether the loan had the potential to facilitate excessive billing practices by plaintiff's counsel. [26]

The recent development of the litigation financing industry has also raised questions about how litigation financing should be treated when considering how to shift costs following the disposition of a claim. In *Warsh* , the Superior Court held that interest on litigation loans does not constitute disbursements, which can be recovered from the losing party as such a practice would create an incentive for plaintiffs to borrow to finance lawsuits. [27] This approach is consistent with existing contract and employment law cases, which have held that interest expenses incurred by the plaintiff as a result of the claim are too remote to recover as special damages. [28] By contrast, the New Brunswick Court of Appeal recently held that when litigation financing is necessary to secure a just determination of a claim, a plaintiff may be entitled to recover reasonable interest expenses as a disburse-

Page 42

ment. [29] However, because litigation loans are frequently success dependent, the interest rate component of these loans will include both the cost of capital and a premium based on the probability of success, and it may be difficult to separate the cost of capital from the litigation risk components. In addition, allowing litigants who have elected to procure litigation financing to recover interest costs poses the question of whether parties who do not receive litigation financing should, similarly, be entitled to claim the cost of the capital impaired by the litigation when allocating costs following the resolution of the claim. Thus, although the New Brunswick Court of Appeal decision raises an interesting question concerning the extent to which the costs of litigation financing should be subject to existing fee shifting regimes, a legislative solution may be required to determine the appropriate rate of interest that parties are entitled to recover on litigation loans.

2. Class Actions

The practice of representative plaintiffs seeking indemnity agreements and financing for legal costs and disbursements are recent developments in Canadian litigation. [30] These agreements give class counsel an additional layer of risk sharing in the costs of the litigation. They also enable lawyers to pursue a larger number of claims at a given time, as opposed to serving as a proxy for traditional contingency fee structures as is the case in jurisdictions such as Australia. [31]

In *Dugal v. Manulife Financial Corp.* , Strathy J. approved a litigation financing agreement that provided indemnity for the representative plaintiff for plaintiff counsel's costs, up to $50,000 in disbursements and any adverse costs awards. [32] In exchange, the financier was entitled to a 7% share in the proceeds of any judgment subject to a cap of $5 million before trial and $10 million thereafter. [33] In approving the agreement, the court recognized the following factors:

Page 43

(a) The funding agreement helps to promote one of the important goals of the *CPA* -providing access to justice. That goal would be illusory if access to justice were deterred by the prospect of a crushing costs award to be borne by the representative plaintiff or counsel. In this sense, the agreement is beneficial to the proper administration of justice: see *McIntyre Estate* , above, at para. 47. Just as contingency fee agreements have been recognized as providing access to justice, so too third party indemnity agreements can avoid the unfortunate result that individuals with potentially meritorious claims cannot bring them because they are unable to withstand the risk of loss: see *McIntyre Estate* at para. 55.

(b) There is no evidence that [Claims Funding International] CFI stirred up, incited or provoked this litigation, within the meaning of the term "moved" in s. 1 of the *Champerty Act* : see *McIntyre Estate* at para. 41. On the contrary, the plaintiffs demonstrated a clear intention to proceed with this litigation before CFI came on the scene.

(c) The indemnification agreement leaves control of the litigation in the hands of the representative plaintiff --- it does not permit officious intermeddling in the conduct of the litigation by the funder, but allows it to receive appropriate information about the progress of the litigation, consistent with its need to manage its own financial affairs, such as posting reserves.

(d) The commission payable (7%) is, in general, reasonable and consistent with the commission (10%) that would be payable to the only other available source, the Fund.

(e) The commission cap ($5 million prior to pre-trial and $10 million thereafter) is also reasonable and is a fair reflection of the potential downside risk facing the funder ($10 million in costs). In fact, in the event of a substantial recovery after trial, it is quite possible that the commission payable to CFI would be substantially less than the commission that would be payable to the Fund in similar circumstances.

(f) The commission is acceptable to the representative plaintiffs, both of who can be fairly described as sophisticated investors and, in the case of the Ironworkers Pension Fund, a sophisticated institutional investor. It is also acceptable to a large and reasonably representative cross-section of class members.

(g) While it is true that one may not be able to say, with absolute certainty, that there is no possibility that the funding agreement might result in a "windfall" recovery to CFI, the possibility of such a recovery, when balanced against the probability of protracted litigation and a somewhat speculative result, is a factor that a commercial risk-taker must take into account in determining the

amount of its compensation. The assessment of the risk can always be defined with greater precision when more information is available, but the fact of the matter is that the plaintiff asks for a decision now. When an insurer sets a life insurance premium, it does not say to the assured, "We'll wait and see how you are doing in a couple of years." It fixes the premium based on the current state of knowledge, recognizing that the applicant may die the next day or live to be 101.

(h) In the existing state of affairs, in which the defendants profess every intention of mounting an aggressive and expensive defence, it is my assessment that the financial terms of the indemnification agreement are a fair reflection of risk and reward.

(i) The plaintiffs are represented by experienced and highly reputable counsel who can be expected to discharge their duties to the plaintiffs, the class and the court without being influenced by the funder.

(j) There will be court supervision of the parties to the agreement. [34]

In approving the financing agreement, Strathy J. distinguished the Ontario Superior Court's prior decision in *Metzler Investment* , which refused to approve a litigation financing agreement prior to certifying the class of plaintiffs. [35] The court recognized that although the views of potential class members are relevant to the approval of a litigation financing agreement, the court has adequate supervisory jurisdiction to account for these interests in order to ensure that the availability of financing is not an impediment to the class action moving forward to the certification stage. [36] This approach is similar to the court's supervisory jurisdiction for approving class counsel's contingency fees prior to certification. However, the extent to which courts should be required to consider the interests of class members and whether class members should be entitled to retroactively challenge the fairness of a litigation finance agreement remains an open question, which should be considered as part of any legislative reform.

Third-party litigation financing agreements are frequently negotiated by class counsel who may also be operating on a contingency fee basis for the plaintiffs. Consequently, these agreements can operate as a form of risk shifting for class counsel, which may ultimately affect the incentives and interests of the

of adverse costs parties. In *Musicians' Pension Fund of Canada (Trustee of) v. Kinross Gold Corp.* , Perell J. indicated that the risk of adverse costs:

. . . discourages access to justice, because the risks of the litigation overwhelm the rewards . . . For example, in a class action where the class's claim in the aggregate is $100 million, a class member with a $100 individual claim would not and could not sensibly take on the risk of paying a defendant's costs of successfully defending an action. [37]

This raises concerns about the degree of alignment between class counsel and the class, since litigation finance agreements can result in class counsel no longer being willing to assume a portion of the risk associated with the litigation. [38] Thus, Perell J. suggests that the Legislature should re-examine the Ontario Law Reform Commission's 1982 *Report on Class Action* 's recommendation that Ontario adopt a no-costs shifting regime for class actions. [39]

Litigation financing can serve as a form of insurance for plaintiffs against litigation costs. In the absence of a no-cost regime, third-party litigation financing agreements allow class counsel and the plaintiff to shift the risk of adverse costs or disbursement awards to a third party, who has direct control over the litigation.

However, litigation financing agreements may also affect the settlement behaviour of the recipient, in that they allow the parties to hedge their personal cost exposure at the outset of the litigation. In a conventional litigation context, either the plaintiff or class counsel --- when the action is being maintained on a contingency fee --- will have an incentive to engage in good faith settlement negotiations since they bear the increasing costs of protracted litigation. However, in a hypothetical scenario where both the representative plaintiff and class counsel were fully indemnified through the use of a contingency fee and litigation financing agreement, the parties may be less likely to engage in settlement negotiations.

Reducing the impact of monetary constraints on a plaintiff's behaviour promotes greater parity *vis-à-vis* well-financed defendants who are often regarded as being more capable of maintaining an action. However, when a plaintiff and class counsel are fully indemnified for adverse costs, the plaintiff will be

Page 46

rationally incentivized to pursue the action further if the marginal return on any future settlement offer is likely to be greater than the costs of the plaintiff's counsel's costs plus the time value of money. These same incentives would also confront defendants who maintain litigation insurance. Therefore, it is important that the court or legislators be attuned to these potentially negative repercussions. In this regard, litigation financing agreements that contain ticking fee or escalator clauses, which increase the amount received by the financier at predetermined intervals or events, may provide sufficient settlement incentives, while still retaining the positive risk shifting benefits offered by these agreements.

3. Defendant's Litigation Insurance

Traditional literature on third-party financing of litigation has focused predominately on the role of financing arrangements offered to plaintiffs. However, defendants also face similar cost pressures which may affect their litigation strategies. In particular, "a defendant's inability to fund a vigorous defence can make it susceptible to agreeing to a quick settlement." [40] As such, litigation financing for defendants also represents an emerging market, which may acquire increasing prominence as corporate clients become increasingly sensitive to legal costs. [41] Although insurance has traditionally served as a form of third-party financing for defendants, which has been allowed largely unopposed by regulators, corporations are also utilizing different strategies to reduce the costs associated with litigation. From a regulatory policy perspective, it is necessary to ensure that both plaintiffs and defendants are accorded equal access to maintain an action on its merits. Thus, any regulatory model should be cognizant of the fact that litigation financing is not a strictly plaintiff-centric issue and that access to justice issues can affect both parties.

Page 47

V. THE REGULATION OF THIRD-PARTY LITIGATION FINANCING

Striking a balance between procedural safeguards for vulnerable litigants and providing a commercial environment which supports the managed growth of litigation financing agreements presents particular challenges for courts and legislators. Litigation financing serves the positive and socially beneficial purpose of leveling the playing-field between plaintiffs and "their better-financed foes." [42] These benefits must be preserved while at the same time ensuring that the industry develops in a manner which advances the policy objectives of access to justice, protection of vulnerable parties and the ability of a plaintiff to litigate a case on its merits. This section considers various regulatory responses for managing the third-party litigation financing industry in Canada.

This part explores three possible methods for regulating third-party litigation financing. First, similar to contingency fees, it may be possible to regulate through the attorney-client relationship. This approach would build on the fiduciary duty of the lawyer to act in the best interests of the client. It takes advantage of lawyers' unique understanding of their client's particular needs and interests. By making the lawyer's fiduciary duty the cornerstone of regulation, it also promotes judicial economy. A drawback of this approach is that it does not foster transparency and consistent regulation of the industry.

A second regulatory approach is to make third-party litigation financing agreements subject to compulsory judicial review, as is presently required in class actions. This approach would apply the existing common law jurisprudence on champerty and maintenance and other doctrines that limit freedom of contract.

Finally, litigation financing could be regulated by statute through the use of either principles-based regulation or the development of mandatory contractual terms. However, the development of standardized contractual terms could prove difficult given the diverse range of circumstances in which litigation financing may be utilized and the degree of risk the litigant wishes to shift.

Under the first possible model, the Law Society of Upper Canada's Rules of Professional Conduct, which impose on lawyers owe a fiduciary duty to act in the best interests of their clients,

Page 48

would be central. [43] Lawyers appear well positioned, because of this fiduciary duty, to advise on whether a litigation financing agreement is appropriate for a client's particular circumstances. In this way, legal advice can have a regulating effect on the terms of these agreements. [44] However, where a litigation financing agreement indemnifies a client against their personal legal fees and disbursements, litigation counsel is placed in an immediate conflict of interest and has a duty to advise the client to obtain independent legal advice with respect to the financing. Although proper independent legal advice will protect the client's interests by assessing the commercial reasonableness of the agreement and ensuring the client's interests are adequately protected during the negotiation process, it is unclear whether this approach offers cost effective regulation. If independent counsel is required to become intimately familiar with the litigation in order to provide nuanced advice on the reasonableness of the fee structure *vis-à-vis* the risks of the litigation, such independent advice may be prohibitively expensive for smaller-value claims. Consequently, the access to justice benefits of such financing may be further limited. If the scope of the duty of the independent legal advisor, however, is only to assess the commercial reasonableness of the loan and ensure the client is aware of the character of the agreement, independent legal advice may be insufficient to regulate the conduct of the litigation funders. As a result, although attorney oversight of litigation financing agreements may have the effect of ensuring that each discrete financing agreement is reasonable, it may be inadequate to provide consistent, industry wide regulation.

In an alternative scenario where litigation financiers provide case specific financing directly to the law firm, lawyer oversight will be similarly inadequate to supervise the conduct of lenders and to ensure the lender is not having an untoward influence on how litigation counsel conducts the case. It may be necessary to ensure that the fee structure of these financing agreements does not pressure the lawyer or the client to settle prematurely, thus benefiting the financing party. Consequently, given the concerns surrounding lawyer oversight, it may be more useful to have an institution or mechanism which is detached from the litigation to oversee these agreements.

Page 49

Under the second model, third-party litigation financing agreements would be subject to mandatory judicial review, as is presently required in class actions. This approach would see judges applying the existing common law jurisprudence on champerty and maintenance and other doctrines that limit freedom of contract, as well as the principles that are set out in *Dugal* , for example. While the approach of mandatory review is sound in the context of class actions, particularly give the representative nature of the action, a model of mandatory judicial review for all litigation where financing is involved may be too resource intensive and, therefore, unsustainable.

A third model would see a new legislative framework, combined with judicial oversight and review of individual financing agreements, as needed where disputes arise. This model would be more sustainable than mandatory judicial review of all financing agreements, given that most financiers and litigants would live up to the principles contained in the new legislation and only disputed agreements would go to court. This model would also provide a more robust framework than judicial oversight alone for regulation of litigation financing agreements because the legislation would set out the expectations, with the judiciary interpreting, applying and enforcing the legislation in the context of disputes. Although the common law is exceptionally malleable and capable of responding to the evolving nature of civil litigation, the incremental, case-by-case approach that is currently the norm lacks the capacity to provide timely and comprehensive regulatory reform. This is not to suggest that the court does not play a critical role in reviewing litigation financing agreements under contract law and the doctrines of champerty and maintenance. Indeed, in a model involving a new legislative framework, the courts would continue to have an important role in ensuring that the legislated principles were applied in a sufficiently flexible manner that reflects and accommodates the broad spectrum of litigants and disputes.

However, it is necessary to recognize the limits of judicial oversight, and where necessary for the legislature to intervene to bridge these jurisprudential gaps. In particular, the doctrines of champerty and maintenance were developed to address the mischief of officious intermeddling in litigation by uninterested third parties. [45] As such, they were designed to protect the parties to a dispute against vexatious and unmeritorious intervention by a third party, who is motivated chiefly by a pecuniary interest in any

Page 50

potential settlement. [46] These principles continue to be relevant in particular segments of the economy such as intellectual property, and aspects of litigation such as the plaintiff's autonomy to direct the course of the litigation or preventing of frivolous lawsuits. However, policy concerns surrounding litigation financing have shifted away from the commencement or operation of the litigation to focus on the relationship between the plaintiff and the financier. In particular, given the increased sophistication of the litigation finance industry, [47] it is this aspect of the relationship which demands the greatest regulatory oversight to ensure the terms are reasonable and do not adversely affect the litigation process. Moreover, the traditional doctrines of champerty and maintenance are, at present, capable of responding to instances where a third party intervenes to encourage or maintain frivolous or vexatious litigation.

Therefore, legislation should be aimed at identifying instances where contract is insufficient to govern the relationship between the financier and the litigant or has the potential to adversely affect the litigation process. Although certainly not the case in all instances, litigation financing has been compared to subprime and other forms of predatory lending because of the potentially vulnerable position of some litigants. [48] There may be a case for a legislated rate cap or limit on fees that a financier can claim, so as to protect vulnerable plaintiffs who cannot vigorously protect themselves in negotiating a contract. However, setting a cap or limiting rates may also have the effect of further disadvantaging some litigants who would otherwise not have the ability to advance their claim. [49] Caps may reduce the availability of lending for litigation that is high risk or has a low probability of success. That said, an upper limit on fees or rates would give parties the flexibility to set their own terms, subject to the broad, over-arching principles in the legislation.

Similarly, in regulating the substantive aspects of the litigation finance industry, legislators should endeavour to create a framework which maximizes the capacity of parties, irrespective of the differences in their sophistication or assets, to negotiate effectively. In a prior work, the author considered whether the disclosure and principles-based model of securities regulation could be applied to

Page 51

litigation financing. [50] Indeed, one of the critical shortcomings of the current, relatively unregulated model for litigation financing is the lack of mandatory disclosure between the parties. Although a party with superior bargaining power may be able to demand more substantial disclosure or resist requests from the opposing party, there is no reciprocal duty for parties to provide full disclosure to the counterparty.

Disclosure of material information by both the financing party and the litigant being financed would promote greater efficiency and market discipline. In 2000, Ontario enacted the Arthur

Wishart Act, which imposes a duty of disclosure and fair dealing on all parties negotiating and implementing a franchise agreement. [51] This legislation may be a useful model to consider in the present context. Material information for a litigant could include disclosure of the financier's model for assessing the litigation risk, probability of a favourable judgment, time-horizons for a potential settlement or judgment, the risk-adjusted profit margins for the loan, and the firm's historic accuracy in assessing the probability of a favourable judgment. Similarly, litigants could be subject to a duty to provide the financier with full disclosure about their claim and any known defences available to the defendant. This information would be of significant assistance for assessing the commercial reasonableness of the loan and enabling the market to more efficiently establish prices. Moreover, such an approach limits the need for direct regulatory intervention involving rate or fee caps, for example, by instead mandating disclosure and reducing the inequality of bargaining power between the parties.

Legislation could also address the potential changes in the settlement incentives that exist for a litigant which has received third-party litigation financing. As previously discussed, reducing the financial barriers to litigation for the defendant could affect the willingness of a plaintiff to settle. Although greater parity between the parties will encourage the resolution of cases on their merits, undisclosed litigation financing may result in inefficient settlement negotiations between the plaintiff and defendant. This inefficiency may arise as a result of the defendant's inability to accurately estimate the resources available to the plaintiff to maintain the litigation and thus their willingness to settle an action. Were the plaintiff required to disclose the existence of a litigation financing

agreement, the incentives for a defendant to leverage its superior resources through procedural manoeuvres would be reduced and there would be greater incentives for the parties to negotiate a settlement or move the trial forward towards an expeditious resolution. Moreover since the defendant does not have standing to challenge the litigation financing agreement *per se* or raise champerty or maintenance as a defence to an otherwise meritorious claim, such disclosure would not appear to present a threat to the plaintiff's trial strategy. [52]

In implementing the proposed disclosure-based approach to regulating third-party litigation funding, it will be relevant to consider recent jurisprudence on whether litigation funding agreements are subject to solicitor-client privilege. In *Musicians' Pension Fund of Canada* , the Ontario Superior Court held that litigation financing agreements are not privileged legal documents because they "must be reviewed in order to ensure that there are no abuses or interference with the administration of justice." [53] In *Stanway v. Wyeth Canada Inc.* , the British Columbia Supreme Court also concluded that these agreements are generally not privileged, but it also said that: [54]

> [T]he confidential communications between the plaintiff, her counsel and a private financer in respect of the merits of the litigation and the litigation budget will be privileged, as well as highly sensitive topics relating to the plaintiff's strategy and trial stamina.

Thus, in formulating the disclosure requirements for litigation financing agreements, the legislators should balance the benefits of increased transparency with the costs of compromising the plaintiff's case by requiring the disclosure of sensitive information.

The strategies discussed above attempt to advance the regulation of third-party litigation financing beyond the traditional doctrines of champerty and maintenance by introducing regulatory strategies successfully employed in other areas of business law. For instance, the use of disclosure-based strategies helps facilitate market-based responses by providing litigants with the information necessary to effectively negotiate with financiers, promoting price based competition among suppliers and enabling litigants to effectively evaluate their litigation risk and settlement options. Similarly, by avoiding a rigid rules-based regulatory framework, consistent standards can be applied to the wide variety of litigation

finance products available. This is not to suggest that the traditional doctrines of champerty and maintenance and other principles limiting freedom of contract are no longer relevant. Indeed, they will remain relevant for regulating the character of the agreement between the financing party and the litigant and ensuring that companies providing litigation financing do not attempt to influence an individual's ability to pursue a claim. Rather, such intervention treats litigation finance in a manner similar to other finance products available to both retail and sophisticated clients. The proposed approach to regulating these agreements responds to the information asymmetry and power imbalance between the financier and the litigant with a principles-based legislative framework governing the relationship between the parties, supplemented by judicial oversight when disputes arise.

VI. CONCLUSION

The continued development of third-party litigation financing in Canada has the potential to dramatically affect the civil litigation process by shifting the balance of power in litigation. However, because of the potential vulnerability of some plaintiffs who rely on third-party financing in order to assert their legal rights, there is a compelling need for a legislative framework and judicial oversight. This article has surveyed the current law and use of litigation financing in order to identify potential challenges. Because of the broad range of litigation financing products and the diversity of claims for which financing may be requested, the author has argued for a principles-based model centred on mutual disclosure of information by both the financier and the litigant. Such a model mitigates the potential power imbalance and information asymmetries between the financier and the debtor. It also ensures that both the plaintiff and defendant are able efficiently to engage in settlement negotiations with full knowledge of the other's capacity to maintain the litigation. Such an approach would promote fair dealing between the financier and the litigant seeking the funding as well as efficient and effective dispute resolution between the plaintiff and the defendant.

ENDNOTES

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Litigation Finance Industry and Its Effect on Settlement" (2006), 155 U. Penn. L.R. 503; Paul H. Rubin, "Third-Party Financing of Litigation" (2011), 38 N. Ky L.R. 673.

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9 *Ibid.* at p. 120.

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11 *McIntyre Estate v. Ontario (Attorney General)* (2002), 218 D.L.R. (4th) 193, 61 O.R. (3d) 257, 23 C.P.C. (5th) 59, 164 O.A.C. 37, 2002 CarswellOnt 2880, [2002] O.J. No. 3417 (Ont. C.A.) at para. 26. Also see *Buday v. Locator of Missing Heirs Inc.* (1993), (*sub nom.* Ollmann Estate v. Locator of Missing Heirs Inc.), 108 D.L.R. (4th) 424, 16 O.R. (3d) 257, 22 C.P.C. (3d) 318, 1 E.T.R. (2d) 237, 68 O.A.C. 97, 44 A.C.W.S. (3d) 687, 1993 CarswellOnt 480, [1993] O.J. No. 2999, 1993 CLB 416, 2002 CLB 410, 5 W.D.C.P. (2d) 38 (Ont. C.A.) , at p. 262.

12 *McIntyre* , *supra* .

13 The Champerty Act is not printed in the Revised Statutes of Ontario, 1990, but remains in effect pursuant to the Unconsolidated and Unrepealed Act, R.S.O. 1990, vol. 12; see *McIntyre* , *supra* , footnote 11, at para. 18; Swan and Adamski, *supra* , footnote 1, at Part XII.1(2).

14 *McIntyre* , *supra* , footnote 11, at para. 32.

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