

## PERSPECTIVES

THIRD-PARTY LITIGATION  
FUNDING IN CANADABY **HOWARD BORLACK AND BEN CARINO**

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In the classic cartoon from *The New Yorker*, a lawyer sits across from a prospective client and remarks: “You have a pretty good case, Mr Pitkin. How much justice can you afford?” Framed in the context of a class action lawsuit, the client may well have asked the lawyer: “I have a pretty good case, Mr Lawyer. How much risk can you tolerate?”

The class action lawsuit is a unique legal procedure. It allows many parties with similar claims to pursue them collectively against a given defendant. Like any other court proceeding, class actions are a risk-reward proposition. The potential for settlement or damages must be weighed against the expense of litigation and, in some jurisdictions, the risk of an adverse cost award. As such, deep

pockets and a high tolerance for risk are often critical to pursue a good case on the merits.

Third-party funding has emerged globally and in Canada as a means by which claimants can pursue a class action lawsuit and minimise their risk to adverse cost consequences for claims that do not succeed. Under this arrangement, a commercial entity funds a class action lawsuit on behalf of claimants in exchange for a percentage of the proceeds. Recently, Ontario courts have taken a leadership role by governing what is essentially a private contract due to the absence of legislation and the unique legal relationship among class action counsel, claimant and funder.

In this article, we discuss the treatment of third-party funding agreements (TPA) by Canadian courts. After a review of the relevant legal principles, we outline the hallmarks of a properly drafted TPA as defined by the courts and discuss undefined areas for future consideration. Virtually all of the substantive case law on third-party funding agreements in the class action context stem from Ontario courts. We therefore focus on these decisions.

### **Risky business**

An economist might describe a class action lawsuit as a cost-effective risk transfer mechanism. Class actions proceed under the same 'loser pays' cost regime as other civil matters in Ontario. As a result, an unsuccessful claim could result in a six or seven figure adverse cost award. Claimants have several viable options at their disposal to transfer such risk. Section 31 of the Ontario *Class Proceedings Act* shelters class members, other than the representative plaintiff, from costs. It also gives the court discretion to award no costs where the class proceeding was a test case, raised a novel point of law, or involved a matter of public interest. Indemnification may also be offered by class action law firms, the Class Proceedings Fund in Ontario, and third-party commercial funders. Of these options, third-party funding has increasingly become a more palatable choice given that funders undertake the

dual risk of upfront litigation expenses and adverse cost indemnification.

Historically, the practice of funding legal action in exchange for future remuneration has been governed by the common law doctrines of champerty and maintenance, which emerged to safeguard a party's best interests and protect the administration of justice against abuse from non-parties. Maintenance is the improper intermeddling in a lawsuit by a party with no legal interest in it. Champerty is a subspecies of maintenance and arises when a 'maintainer' shares in the profits of litigation. Courts have held that a person's motive is determinative of whether an arrangement constitutes maintenance or champerty.

Over time, Ontario courts have carved out exceptions to otherwise champertous acts in the presence of suitable justification. Ontario courts have recently held that funding agreements in the class action context are not champertous *per se*, as long as they adhere to certain guidelines. Some of these key principles are discussed below.

### **Anatomy of a third-party agreement**

Champerty and maintenance continue to underpin the various Ontario judgments that have considered third-party funding agreements. Principles such as control, transparency and reasonable compensation are primary considerations during motions to approve funding

agreements. Below, we discuss five hallmarks of a properly drafted TPA.

#### *Leave the big decisions to the plaintiff*

An Ontario court will likely reject a TPA unless it leaves final decision-making authority in the hands of the plaintiff. In *Metzler Investment GmbH vs. Gildan Activewear Inc.*, [2009] O.J. No. 3315 (*Metzler*), the court dismissed a motion to approve a TPA. It took particular exception to provisions that allowed the

funding party to attend settlement discussions and to unilaterally withdraw from litigation on seven days' notice. Presumably, such a withdrawal could wield considerable influence by cutting off litigation funding and re-exposing the representative plaintiff and/or class counsel to an adverse cost award. Two years later, the court in *Dugal et al. vs. Manulife Financial Corporation et al.*, 2011 ONSC 1785 (*Dugal*) went a step further by requiring the funder to insert a provision stating that litigation control remained with the representative plaintiff.

#### *Don't ask for too much*

Ontario courts will favour funding agreements that contain reasonable caps on maximum returns. In *Metzler*, Justice Leitch concluded that a TPA would be champertous if it was spurred by an improper motive, and that the terms of remuneration were key to determining whether a funder's motive was improper. This principle was revisited in *Dugal*, where the court approved a TPA that allocated 7 percent in commission up to a maximum cap of C\$5m prior to pre-trial and C\$10m thereafter. In approving the TPA, Justice Strathy remarked that the maximum cap was reasonable in light of the potential downside risks facing the funder.

#### *Put your cards on the table*

Class action counsel and third-party funders should be prepared to disclose the terms of the funding agreement. In *Fehr vs. Sun Life Assurance*



*Company of Canada*, 2012 ONSC 2715, the moving party sought an order to hold a TPA approval motion in the absence of the defendant and the general public. The court refused to grant the order. Justice Perell held that the terms of the TPA were not privileged in law. He further ruled that a motion to approve must be made on notice to the defendant, that the motion should be open to the public, and that court approval is mandatory for a TPA to come into force.

Given the level of transparency required by the court, funders and class counsel would be wise to ensure that their agreements do not include details on litigation strategy or budgetary limitations, which could easily compromise the integrity of the case and provide the defendant with leverage during negotiations.

#### *The flow of information must be controlled*

Third-party funders have limited rights when it comes to information obtained from litigation. In *Dugal*, Justice Strathy recognised that it was reasonable to provide a third-party funder with information regarding settlement offers and class counsel's assessment of liability and damages. Nevertheless, he suspended the approval of a TPA to ensure reasonable controls on the provision of information to the funder. The parties were asked to

revise the TPA. According to the new agreement, the funder could not obtain evidence from the defendant without its consent. The plaintiff was also allowed to disclose formal settlement offers from the defendant provided that the terms remained confidential.

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#### *Prepare for a long-term financial commitment*

An Ontario court may favour a TPA that envisions the participation of a third-party funder from start to finish. As noted earlier, the court in *Metzler* took exception to a provision in the TPA that would have allowed the funder to abandon the case on seven days' notice. Furthermore, in an effort to ensure the financial commitment of third-party funders, the courts in *Dugal* and *Bayens* required the funders to post security for costs.

Nevertheless, it may be possible for funders to negotiate a release clause under reasonable circumstances. In *Metzler*, Justice Leitch did not

take issue with a provision that allowed the funder to remove itself from the action if the plaintiff failed to “fulfill its obligations under the agreement, if the plaintiff appoint[ed] different lawyers to replace current class counsel and for any other reason on seven days’ notice”.

### Final thoughts

Third-party funding appears to be a mainstay in Ontario. Absent legislative intervention, it will continue to operate in the short term as a court-regulated economic enterprise. The degree to which the court can, or should, intervene further is a question for another day.

It is difficult to determine how many potential class actions have not been advanced due to the expense of litigation and potential cost awards. Whatever

the number, it is likely that an increase in third-party funding will generate an increase in class action litigation. **CD**



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