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EXPECT THE BEST

# Third-Party Funding of Commercial Litigation is Becoming Increasingly Common in Ontario

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Commercial actors who want to begin a lawsuit in Ontario but don't have the money on hand or want to minimize their costs may turn to third parties to help them in funding the litigation.

Courts have traditionally taken a dim view of third-party litigation funding. Today, however, as the costs of civil litigation rise in Ontario, the courts appear to be reconsidering their traditional stance on "litigation trafficking" in favour of encouraging more access to justice.

In that context, business people are now financing litigation for strangers in Ontario with a view to turning a profit, and this is emerging as big business.

While this funding has the potential to ease the financial burden on plaintiffs, there are inherent risks in it that must be managed appropriately. Parties considering third-party litigation funding must work with counsel to ensure that their best interests are being served.

The long-standing disdain for third-party litigation funding was born from the idea that allowing pathological profiteers to run lawsuits in which they had no legitimate interest encouraged frivolous litigation and was contrary to the public interest.

In fact, until relatively recently such agreements were usually found to be illegal. To be sure, third-party litigation funding raises many ethical issues for lawyers, chief among them: potential pressures on confidentiality and lawyer-client privilege because the people paying the piper are neither a party to the dispute nor that party's lawyer.

The reality is, however, that without these sources of funding, a certain percentage of legitimate civil cases may never see the light of day. The question is: at what price?

There are three types of litigation funding that we see emerging:

1. Third-party funding for class actions;
2. Litigation loans for individual civil litigants; and
3. Funding agreements between financing companies.

#### 1. Recent Developments in Third-Party Litigation Funding in Class Actions

In May, 2012, Justice Paul M. Perell of the Ontario Superior Court of Justice issued a decision in *Fehr v. Sun Life Assurance Co. of Canada* that, while going a long way towards legitimizing third-party litigation funding in class actions, also sought to create some ground rules. In particular, Justice Perell found that third-party funding in class actions must be transparent and must be reviewed by the courts to ensure that there are "*no abuses or interference with the administration of justice*." Justice Perell also refused the plaintiffs' motion to seal the information disclosed on the motion approving the third-party funding agreement on the basis that there was no confidentiality or privilege in such agreements. (Privilege exists only between the lawyer and the client. If additional parties are involved, the privilege may be lost.)

More recently, in July, 2013, Justice Perell was again asked to approve a third-party funding agreement in a different class action: *Bayens et al. v. Kinross Gold Corporation*. This time, he took the opportunity to summarize the state of the law in this emerging field. Among other things, he found that: while third-party funding agreements are not necessarily illegal anymore, in some instances they still may be; in the class-action context these agreements must be pre-approved by the court to ensure that there is no injustice; and in order for these agreements to be legal, they must not compromise or impair the lawyer-client relationship or the lawyer's duty of loyalty and confidentiality to his client. Nor may they impair the lawyer's professional judgment in the carriage of the litigation.

For plaintiff-side class counsel, these recent cases mean that third-party funding agreements in the class action context must be disclosed quickly, and approved by the courts in a public forum. These developments also mean that parties drafting these agreements must be very careful not to include privileged or confidential information in such agreements because they will be disclosed not only to the court, but to opposing counsel and the public at large.

Once you overcome the procedural hurdles, the costs for the funding will usually be a percentage of the net recovery obtained by the plaintiff. In the *Kinross* case, that would be 7.5 per cent of the net recovery before the class action was certified, and 10 per cent afterwards. In the class action context, the fairness of these lending agreements will be determined on a case-by-case basis.

### 2. 'Pay-Day Loans' in the Civil Litigation Context

If you Google "legal finance in Ontario," you will find several companies operating in the province whose only business is to invest in litigation for strangers. Not all of them are reputable. Given that commercial litigation funding is a relatively new phenomenon that is virtually unregulated in Ontario, it is not surprising that a few opportunists have emerged.

In a 2011 decision of the Ontario Superior Court of Justice in *Guiliani v. Region of Halton*, Justice John Murray had to consider whether the winning plaintiff in a motor-vehicle accident case should be reimbursed for the loan interest she paid to a third-party litigation funding company. In so doing, Justice Murray was very critical of the rates of interest charged by the funding company which, in the Court's view, were usurious. Even though the terms of the loan only required the plaintiff to pay in the event she was successful, the interest charged on the loan was almost two-thirds of the amount loaned to her by the end of trial, with the funding company having an assignment of the plaintiff's right, title and interest in any proceeds from the litigation.

Justice Murray refused to compensate the plaintiff for the interest charged, noting: "*this Court should not reward, sanction or encourage the use of such usurious litigation loans*." Justice Murray was concerned that allowing plaintiffs to be reimbursed for the interest charged by the third-party lender "*would not facilitate access to justice and would probably bring the administration of justice into disrepute*." The result for the plaintiff was a substantial decrease in the net judgment she obtained.

So, while third-party litigation funding may, in some cases, increase access to justice for plaintiffs, the potential costs are significant and should be considered in advance.

### 3. Funding Agreements Between Commercial Actors

Funding pool agreements are the most sophisticated of the three types of third-party litigation funding agreements, and can operate as self-insurance for commercial actors in the lending business. For instance, parties that are often involved in the same type of financing agreements (a certain percentage of which have a habit of ending up in litigation) may enter into agreements in advance to manage both credit and litigation risks. One way to do this is to set aside money in a pool every time a financing agreement is struck. Should litigation arise, funds may be available in the pool to pay for it. Generally, in the event of default, only one of the parties to the funding agreement will pursue the litigation on behalf of the 'fund,' meaning that, in a technical sense, at least part of the money used to fund the litigation is derived from a 'third-party' to the action, qualifying them as third-party funding agreements.

The benefit of these agreements is that they can be tailored to the precise needs of the parties entering into them, and it is unlikely that a court will interfere with them – particularly when the bargain was reached between two sophisticated commercial actors. Unlike funding agreements in the class actions context, these agreements don't need to be approved by a court in advance. In fact, if you are lucky, there is no reason that these funding agreements will ever see the inside of a courtroom.

The only difficulty with these funding agreements is that if you do proceed to litigation with a debtor, the *Rules of Civil Procedure* in Ontario require disclosure of a broad array of documents, including insurance policies capable of responding to the litigation. As a result, parties may be required to disclose not only the existence of this type of funding agreement, but the funding agreement itself. With this in mind, counsel drafting these agreements must be careful not to include sensitive, proprietary or confidential information in such agreements. ■