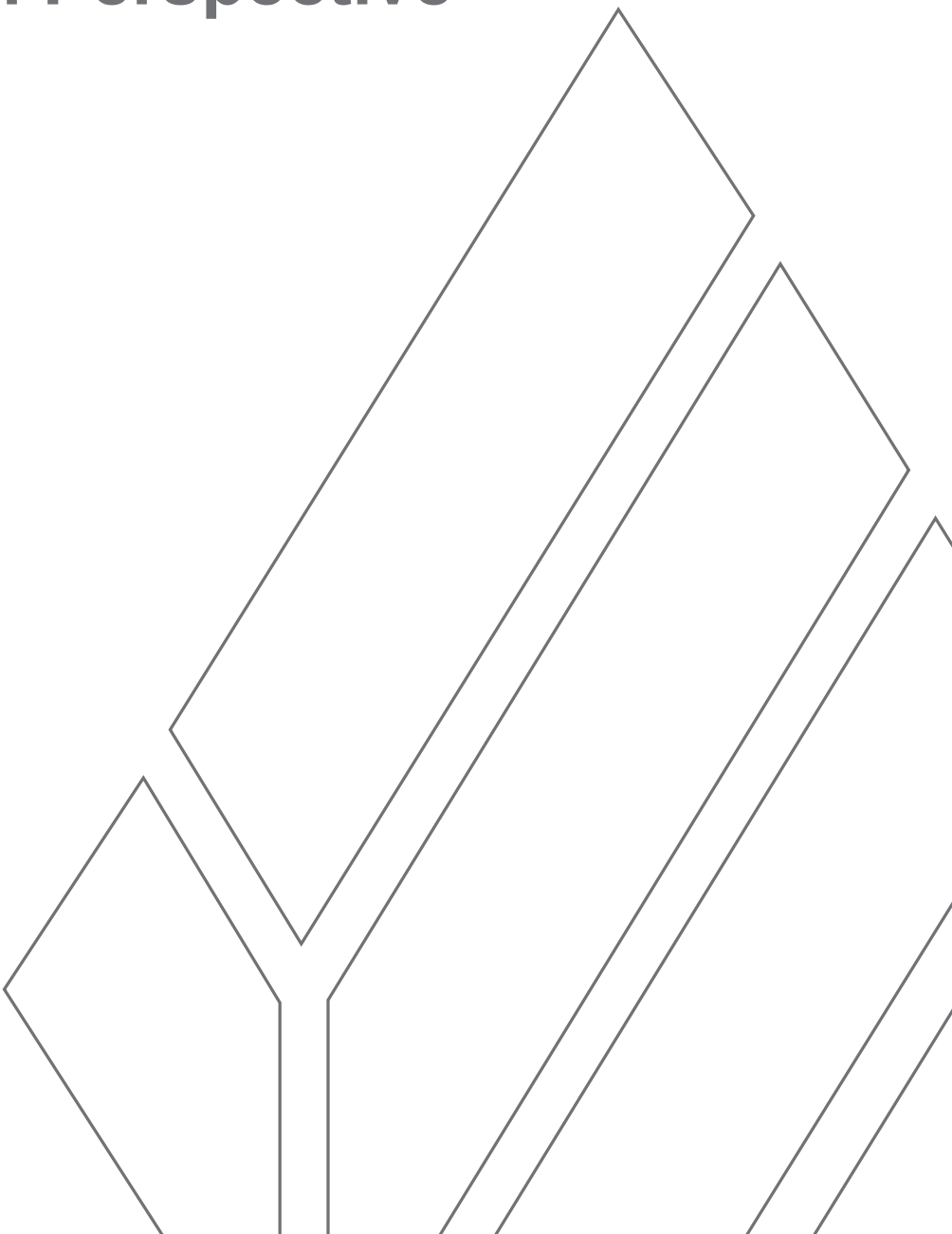
BENTHAM IMF

Litigation Funding Roundtable:
The Canadian Perspective



SEPTEMBER 2016

In September 2016, Bentham IMF hosted a panel of experts, litigators and academics from Canada, Australia and the U.S. in Toronto to discuss the Canadian perspective on litigation funding. As with similar events previously hosted by Bentham's offices in New York and California, the discussion focused on how litigation funding might serve the local legal market and on the legal and ethical questions that often arise in funding transactions.

This paper summarizes some of the key discussion points and opinions shared by the roundtable members.

A. Executive Summary

Already well established in Australia, the U.S. and elsewhere, litigation funding makes advancing large-scale, commercial litigation easier, less risky and more financially appealing for litigants. In Canada, the funding of commercial claims is still relatively new. As a result, it is relatively unknown, perceived through a narrow lens, often misunderstood and excites controversy.

The roundtable agreed that litigation funding could benefit the Canadian legal market in several important ways. For example, funding can:

- provide access to justice for those who cannot properly resource their litigation;
- enable corporate clients to more effectively manage cost and risk;
- permit counsel to take on cases they might not otherwise be able to accept; and
- generate more efficient and reliable revenue sources for law firms.

As with many new or disruptive developments in the legal sphere, there are a number of professional and ethical questions relating to litigation funding. These include whether:

- litigation funding is contrary to the doctrines of maintenance and champerty;
- the litigation funder can play a role in the conduct of the litigation;
- the litigation funding arrangement deals adequately with any conflicts of interest that may arise;
- a client waives privilege by disclosing documents to a funder;
- funding arrangements should be disclosed to the defendant and/or the court; and
- the litigation funder's terms are fair.

Ultimately, the roundtable concluded that these ethical concerns are either manageable under current rules and regulations or more apparent than real.

In short, the consensus saw a real benefit to the growing availability of litigation funding in Canada. Specialist commercial litigation funders have an important role to play in the principled development of the industry.

B. Commercial Litigation Funding Explained

In a typical litigation funding transaction, the funder (who is not a party to the litigation) pays all or part of a party's litigation costs in return for a fee. These costs typically include lawyers' fees, expert reports and other disbursements. The funder may also provide working capital to the client. In addition, the funder typically will agree to pay any court-ordered costs, including any security for costs.

Any type of commercial claim may be suitable for funding, including business disputes, insolvency matters and arbitrations.

While there are other companies in Canada that provide disbursements and adverse costs indemnities for personal injury and/or class action matters, that type of funding is distinct from commercial litigation funding.

C. The Canadian Context – The "Maple Leaf Hybrid"

Although litigation funding is relatively established in both Australia and the U.S., important differences in those countries' legal systems have resulted in divergent funding practices.

For example, in Australia, contingency fees are prohibited and there is a harsh adverse costs regime. As a result, it can be very hard to pursue cases absent external funding. When cases are funded in Australia, funders typically pay the lawyers' full hourly fees and will meet any court-ordered costs.

By contrast, in the U.S., contingency fees are prevalent in commercial litigation and adverse costs are very rare. As a result, funders in the U.S. often cover only a portion of the law firm's fees as a case progresses, and the law firm carries the reminder in return for a partial contingency fee. Unlike in Australia, the risk of paying court-ordered costs does not need to be allocated in the U.S.

Canada is essentially a "Maple Leaf Hybrid" between these jurisdictions. Contingency fees are permissible, although they are not common in commercial litigation. In most provinces, there is an adverse costs regime, but the awards are not as high as in Australia. This dynamic means there is real opportunity for flexibility in litigation funding arrangements in Canada, depending on the needs and risk appetite of clients and law firms.

D. The Benefits of Litigation Funding

The roundtable considered the myriad ways that litigation funding can meet the needs of Canadian litigants and law firms and, in doing so, benefit the legal system as a whole.

1. Access to Justice

One key benefit of litigation funding is improved access to justice. This has broad and positive implications for parties unable to pursue cases due to financial constraints. Litigation funding levels the playing field for those with claims against much better capitalized defendants. Further, working capital funding can help a business stay afloat during the disruptive and protracted period of litigation.

As David Lederman noted, “Funding plays a role in access to justice and in some circumstances allocation of risk. It isn’t something to fear. It’s a new way to get valid claims to court.”

2. Corporate Client Budget Pressures and Risk Aversion

Many corporate counsel are faced with contracting legal budgets already strained by the cost of corporate and regulatory matters or defending litigation.

The risks of pursuing plaintiff-side litigation can be unpalatable to Canadian corporations who are increasingly focussed on managing risk in all areas of their businesses. Lincoln Caylor suggested that there may not be an appetite amongst Canadian corporate counsel to pursue such cases due to concerns about risk, cash flow, reputation or management time. Often the perception is that it might be easier and more economical to write off the loss.

Litigation funding can alter this cost-risk analysis. It enables corporations to pursue litigation off balance sheet and without the need to record a contingent liability for any adverse outcome.

At the same time, the company can monetise the litigation asset, protect its reputation in the industry and play a part in promoting accountable corporate conduct.

3. Law Firm Profitability

Jacqueline Horvat commented that there is a perception by some lawyers that litigation funding could be a threat to their firm’s revenue. However, the reality is that by working with a litigation funder, law firms can generate additional workflow, increase profitability and smooth cash flow.

Litigation funding can boost law firm revenues by allowing lawyers to take on both new clients and additional work for existing clients with litigation that they might not otherwise pursue.

Lawyers can take cases on a full or partial contingency basis, with the potential for significant rewards, and use litigation funding to smooth out their cash flow and reduce their risk.

4. Insolvency Cases

In the insolvency context, litigation funding allows an insolvency or restructuring professional to unlock the value of a litigation asset, including litigation that was ongoing at the time of the insolvency as well as causes of action arising out of the insolvency.

In Australia, litigation funding has been widely used by the insolvency profession for over a decade. One advantage of using external funding is that the receiver or trustee can make an interim distribution to creditors and use litigation funding to investigate and pursue valid claims. It also transfers the risk of court-ordered costs to a third party.

As Andrew Saker noted, “Litigation funding has been used to unlock the benefit of assets that would otherwise remain unavailable to estates that are unfunded. There is a raft of case law in Australia that makes it almost imperative that this type of funding is available.”

Aubrey Kauffman noted the practicality of litigation funding compared to other financing options that have been used in Canada, stating “We struggle to try to figure out models for funding. We use debt financing, major creditor funding or contingency arrangements where the lawyer takes the risk, coupled with litigation trusts. However, none of these solutions are particularly prevalent or easy. Litigation funding is an easier process for a trustee to work with and get court approval of.”

E. Legal and Ethical Issues

Though the benefits of litigation funding are substantial, stakeholders unfamiliar with the practice often hesitate to pursue funding due to concerns about legal and ethical issues that might arise. These concerns, however, are easily managed when transacting with a reputable and principled funder.

1. Maintenance and Champerty - The Quantum Shift in Canada

An oft-cited impediment to the development of litigation funding in the common law world, including Canada, has been the doctrines of maintenance and champerty. These principles were described by the Ontario Court of Appeal in *McIntyre Estate* as follows:

> [m]aintenance is directed against those who, for an improper motive, often described as wanton or officious intermeddling, become involved with disputes (litigation) of others in which the maintainer has no interest whatsoever. Champerty is an egregious form of maintenance in which there is the added element that the maintainer shares in the profits of the litigation.[1]

However, courts have more recently indicated that these ancient doctrines do not bar commercial litigation funding in Canada. In the seminal case of *McIntyre Estate*, the Ontario Court of Appeal held that a contingency fee arrangement was not *per se* champertous. In so doing, the court endorsed a flexible approach to maintenance and champerty.

This line of reasoning was followed in the recent decision in *Schenk v. Valeant Pharmaceuticals*, the first Canadian case to consider the type of litigation funding discussed at the roundtable. In *Schenk*, Justice McEwen held that litigation funding was not *per se* champertous, and there was "no reason why such funding would be inappropriate in the field of commercial litigation."[2] A funding arrangement could, however, be champertous if the funder stirred up the action, exerted unreasonable control, or charged an excessive fee.

2. The Role of the Litigation Funder and Conflicts of Interest

Reputable litigation funders do not seek to control litigation. In order to monitor their investment, they seek updates on key developments and ask to be consulted on important decisions. The consultative process with experienced ex-litigators is often considered a "value add" by clients.

Control issues become most acute when the client receives an offer to settle the litigation and the funder and client disagree on whether the offer should be accepted. Ralph Sutton explained that this is an extremely rare event.

The litigation funding agreement should set out a dispute resolution mechanism to address any such disagreement. Will McDowell commented that a "short fuse arbitration" clause similar to that used in commercial lease disputes would be appropriate.

3. Privilege

The consensus is that both solicitor-client privilege and litigation privilege protect documents and information shared by a plaintiff and its counsel with a litigation funder.

---

[1] *McIntyre Estate v Ontario (Attorney General)* (2002), 61 O.R. (3d) 257 (C.A.) at para. 26.

[2] *Schenk v. Valeant Pharmaceuticals International Inc.*, 2015 ONSC 3215 at para. 8.

Solicitor-client privilege enjoys stronger legal protection in Canada than in Australia and the United States. Whilst there is no law directly on point, based on current Canadian jurisprudence, solicitor-client privilege should cover all confidential discussions and exchange of documents between a client, its counsel and the funder. It should also cover a legal opinion prepared by the funder's in-house legal counsel for the funder's investment committee.

The well-established Canadian law on litigation privilege protects communications made for the dominant purpose of litigation, and the roundtable expected that it would extend to communications between the client, counsel and the funder.

4. Transparency

The roundtable considered the advantages and disadvantages of disclosing a funder's presence in a case and/or the funding agreement itself.

Whilst some plantiffs may not want to disclose that they have assistance from a litigation funder, defendants may be less likely to engage in "scorched earth" tactics when they know the plaintiff has robust financial support.

Transparency is also likely to be important to the judiciary. As David Lederman explained, "*Schenk* demonstrates that openness is the right approach. The judiciary wants to see what the process is, and judges don't want people hiding and disclosing late in the day that they have a funder. You're better off if the judge knows the full picture."

Another benefit of transparency for a litigation funder is the ability to access key documents in the litigation. In *Schenk*, Justice McEwen concluded that because the funder attorned to the jurisdiction of the court, it would be bound by the deemed or implied undertaking rule and thus could access documents disclosed in the litigation process.

The roundtable participants found this approach reasonable and believed other courts would follow this lead.

5. Funder's Return

Ensuring that the client, lawyers and funder each get a fair return is important to a sustainable litigation funding industry. Andrew Saker noted that "Any industry can attract extreme players. Here, for example, hedge funds are not funders of litigation in a systemic way. They may charge disproportionate fees and try and push the envelope. It is through the establishment of litigation funding as a proper industry that it will evolve, as it has in Australia, with the bulk of settlement and judgment amounts being returned to the clients." In Canada, the *Schenk* decision provides some guidance to ensure a fair return to the client.

F. The Future of Funding in Canada

While there is good reason to be optimistic about the future of funding in Canada, much remains to be done to educate the legal community and litigants about its potential benefits. Whilst seasoned litigators continue to observe litigation funding with a cautious eye, the next generation appears far more enthusiastic. For example, Stephanie Ben-Ishai pointed out that many of her students are excited about the prospect of litigation funding and that it is a significant enough development to be included in some law school curricula.

The growth of litigation funding goes hand-in-hand with other rapidly evolving innovations in business and the practice of law. Many law firms have been exploring alternative fee models with their clients for some time, and clients are looking for ways to manage risk. Litigation funding will continue to be an important part of that conversation.

The roundtable agreed that litigation funding has a promising future in Canada, particularly as stakeholders learn more about its benefits and understand how other jurisdictions have addressed ethical issues that emerge.

Tania Sulan and Naomi Loewith of Bentham Canada wish to thank the roundtable participants for their valuable insight and contributions:

- Stephanie Ben-Ishai, Professor, Osgoode Hall Law School and Affiliated Scholar, Davies Ward Phillips & Vineberg LLP
- Lincoln Caylor, Bennett Jones LLP
- Jacqueline Horvat, Spark LLP and Sessional Instructor/Lecturer, Windsor Law School
- Aubrey Kauffman, Fasken Martineau DuMoulin LLP
- David Lederman, Goodmans LLP
- William McDowell, Lenczner Slaght Royce Smith Griffin LLP
- Andrew Saker, Managing Director and CEO Bentham IMF Limited (Australia)
- Ralph Sutton, Chief Investment Officer and Legal Counsel, Bentham Capital LLC (U.S.)

Bentham IMF Capital Limited is the Canadian arm of Australian litigation funding pioneer Bentham IMF Limited. Bentham IMF Limited was launched in 2001 as a publicly traded company (ASX: IMF). Since then it has invested in more than 240 lawsuits, with a 90 percent success rate in 187 completed cases.

BENTHAM IMF

250 The Esplanade, Suite 127
Toronto, ON M5A 1J2
416 583 5720

benthamimf.ca