Commercial Third Party Funding of Class Actions in Ontario: Eight Early Lessons

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"Third-party funding evens the battlefield in securities class actions in Canada. Defendants' counsel are billing on a regular basis and receiving payments on a regular basis. And in most cases, they have access to a wide array of resources that plaintiffs' counsel simply don't have and can't afford."

-Megan McPhee, Kim Orr Barristers P.C.[1]

"Given the size of the potential costs awards in this action and the Labourers Fund's losses, the trustees are not willing to act as plaintiffs without an indemnity for adverse costs. While healthy public markets are an important concern for the Labourers Fund, the risks are not justifiable without funding for adverse costs."

-Joseph Mancinelli, chair of the board of trustees of the Labourers' Pension Fund of Central and Eastern Canada, plaintiffs in *The Trustees of the Labourers' Pension Fund of Central and Eastern Canada v Sino-Forest Corporation* [2]

"[A]s presently drafted the Agreement creates a potential circumstance wherein CFI could influence the decision making within this litigation to fulfill its own motivations. That could amount to officious intermeddling and could create the potential for this litigation to be influenced by extraneous interests and agendas."

-*Metzler Investment GmbH v Gildan Activewear Inc.*[3]

"The propriety of third party funding agreements is controversial and problematic and, in my opinion, at a minimum, they should not be allowed to operate clandestinely… There is a legitimate concern that if not regulated, third party funding might subvert the public policy purposes of class proceedings."

-*Fehr v Sun Life Assurance Company of Canada*[4]

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[1] As quoted in S. Rubin, "Enter the Silent Partner" *Lexpert Magazine* (July/August 2011) 56 at 58.

[2] Affidavit of Joseph Mancinelli sworn February 15, 2012, Motion to Approve Funding Agreement, *The Trustees of the Labourers' Pension Fund of Central and Eastern Canada v Sino-Forest Corporation*, Court File No. CV-11-431153-00CP

[3] 2009 CanLII 41540 (Ont SCJ) at para 60 [*Metzler*].

[4] 2012 ONSC 2715 at para. 90 [*Fehr*].

INTRODUCTION

Commercial third party funding of class actions is a relatively new phenomenon in Ontario, but has gained a foothold here. This development is of particular interest to the securities bar; in these early days, securities litigation appears to be the favoured arena for commercial funders of class proceedings.[5] For proponents of third party funding, expanding the range of financing options is consistent with improved access to justice, one of the recognized goals of the class proceedings regime. A number of concerns have been raised, however, about the potential impact of third party funders on the conduct of litigation, including the potential for outside interference, and for conflicts of interest. While the long-term viability of the phenomenon in Ontario remains to be seen, the early cases indicate that courts here are willing to give such arrangements a cautious try, and procedural and substantive parameters for approving them are starting to emerge. This paper discusses the lessons that can be drawn from the Ontario experience so far – including that we do not yet know all the rules.

BACKGROUND

A. WHAT IS THIRD PARTY FUNDING?

In this context, third party funding refers to a for-profit service provided by a commercial enterprise, involving financial assistance to claimants in class proceedings in exchange for a share of proceeds in the event of success in the litigation. In theory, such funding is available to address the gamut of a litigant's financial concerns, including lawyers' fees, disbursements, and the prospect of liability for an adverse costs award. For example, Bridgepoint Financial Services Inc. ("Bridgepoint"), a Canadian firm, describes its services generally in this area as follows: "indemnification for the representative plaintiff in class proceedings"; "disbursement/working capital financing for counsel"; and "financing legal fees".[6] Similarly, Claims Funding

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[5] With one exception (*Fehr*), the reported decisions discussing such arrangements in Ontario have involved securities class actions: *(Metzler*; *Dugal v. Manulife Financial Corporation*, 2011 ONSC 1785 [*Dugal*], supplementary reasons 2011 ONSC 3147 [*Dugal (supplementary)*]; *The Trustees of the Labourers' Pension Fund of Central and Eastern Canada v Sino-Forest Corporation*, 2012 ONSC 2937 [*Labourers' Pension Fund*]).

[6] Bridgepoint website, online: <http://www.bpfin.com/classaction> (retrieved August 15, 2012).

International, plc ("CFI"), based in Ireland, "funds cases by paying lawyers fees, experts fees, court costs and all other expenses incurred by the claimants in pursuing the litigation" and "will assume the risk of adverse costs or pay insurance to cover that risk".[7]

In practice, the rules regarding what an enforceable third party funding agreement can look like are still emerging in Ontario. Reference can now be had, however, to two reported cases in which particular third party funding arrangements have been approved by the court (both involving CFI): *Dugal v Manulife Financial Corporation*,[8] decided in 2011 and *Labourers' Pension Fund v Sino-Forest Corporation*,[9] decided in 2012.[10] In each case, the agreement has featured (1) an indemnification of the plaintiff for any adverse costs award and (2) a commitment to pay $50,000 towards disbursements, in exchange for a commission on any judgment or settlement, subject to a sliding cap. Specifically, in *Dugal*, the commission was 7% (capped at $5 million, or $10 million, depending on the stage at which resolution of the litigation occurs); in *Labourers' Pension Fund*, the commission was either 5% or 7%, and capped at either $5 million or $10 million, depending on the stage at which resolution of the litigation occurs.[11]

B. WHAT IS THE RATIONALE FOR THIRD PARTY FUNDING AGREEMENTS?

Central to an understanding of why courts have begun to consider – and approve – third party funding agreements is the economic context in which they arise. Class proceedings present unique financial considerations for all parties, but for class members and representative plaintiffs

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[7] CFI website, online: http://www.claimsfunding.eu/apply-for-claims-funding.html (retrieved August 15, 2012).

[8] *Supra* note 5.

[9] *Supra* note 5.

[10] In *Metzler*, after initially dismissing a motion to approve such an agreement as premature (as discussed elsewhere in this paper), the court subsequently approved an amended agreement in an unreported decision: see *infra* note 31. In addition, there are two other known cases in Canada in which third party funding agreements have been approved (both involving Bridgepoint) – *Hobsbawn v ATCO Gas and Pipelines Ltd.* (Alta. Q.B. May 14, 2009) [*Hobsbawn*] and *MacQueen v Sydney Steel Corp.* (N.S.S.C. October 19, 2010) [*MacQueen*] – but in those cases, the orders were made without reasons: *Dugal* at paras. 21-22.

[11] It has been reported that in *Hobsbawn* and *MacQueen*, the commission is 3.5%: S. Rubin, *supra* note 1 at 60.

in particular.[12] In most cases, the individual claim of the representative plaintiff (or any given class member) is not large enough to justify footing the cost of lawyers' fees and disbursements. Of special concern to representative plaintiffs is that, under the class proceedings regime adopted in Ontario, they are personally exposed to liability for any adverse costs awards, which may dwarf the relief they stand to gain individually in the proceeding. As expressed by Strathy J. in *Dugal*:

> The grim reality is that no person in their right mind would accept the role of representative plaintiff if he or she were at risk of losing everything they own. No one, no matter how altruistic, would risk such a loss over a modest claim. Indeed, no rational person would risk an adverse costs award of several million dollars to recover several thousand dollars or even several tens of thousand dollars.[13]

The prospect of significant costs awards against plaintiffs in class proceedings in Ontario is quite real. Just in recent weeks, awards have been made against plaintiffs of over $700,000 for a certification motion,[14] and over $1.7 million for a common issues trial.[15]

Short of "passing the hat" among class members, other means of addressing these financial considerations are necessary.

Often plaintiffs' counsel will take on some or all of the financial risk that would otherwise be borne by representative plaintiffs or class members. For example, contingency fee agreements relieve the plaintiff of the burden of coming up with funds to pay counsel's fees as they arise (or at all, if the claim is unsuccessful), and were made permissible for the purpose of class actions in Ontario, as part of the introduction of class proceedings legislation in 1992.[16]

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[12] For a comprehensive summary of the economic theory behind class actions, see the discussion by Justice Perell in *Fehr* at paras. 35ff.

[13] *Dugal* at para. 28.

[14] *Martin v. Astrazeneca Pharmaceuticals Plc*, 2012 ONSC 466.

[15] *Smith v. Inco*, 2012 ONSC 5094.

[16] See s. 33 of the *Class Proceedings Act, 1992*, S.O. 1992, c. 6.

Plaintiffs' counsel may also agree to take on responsibility for the up-front payment of disbursements, and/or to indemnify representative plaintiffs in respect of any adverse costs awards. However, because these elements involve the prospect of financial outlay (as opposed to deferred compensation), plaintiffs' counsel may be more reluctant to assume the associated risk, or may simply not be in a financial position to offer such an arrangement. These options become less attractive to (or feasible for) plaintiffs' counsel the greater the anticipated disbursement expenses and potential adverse costs awards.

In Ontario, a further option for transferring away from plaintiffs some of the financial risks of class action litigation is the Class Proceedings Fund. The Legislature established the Class Proceedings Fund as an account of the Law Foundation of Ontario in conjunction with the enactment of the *Class Proceedings Act, 1992* ("the *CPA*"). Pursuant to the *Law Society Act*, the purposes of the Class Proceedings Fund are:

> 1. Financial support for plaintiffs to class proceedings and to proceedings commenced under the Act in respect of disbursements related to the proceeding; and
>
> 2. Payments to defendants in respect of costs awards made in their favour against plaintiffs who have received financial support from the Fund.[17]

The *Law Society Act* creates the Class Proceedings Committee (the "Committee"), which is mandated to deal with requests for financial support from the Class Proceedings Fund. On application by a plaintiff, the Committee may direct that appropriate payments be made from the Class Proceedings Fund to the plaintiff in respect of disbursements, having regard to various criteria set out by statute and regulation.[18]

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[17] *Law Society Act*, s. 59.1.

[18] *Law Society Act*, ss. 59.2-59.3; Class Proceedings Regulation [Law Society Act], O. Reg. 772/92 (as amended), s. 5

Where the Fund is used to provide financial support to a representative plaintiff, the *Law Society Act* also makes the Fund financially responsible for any costs award made in favour of a defendant against that plaintiff. Section 59.4(1) of the *Law Society Act* provides as follows:

> 59.4 (1) A defendant to a proceeding may apply to the board for payment from the Class Proceedings Fund in respect of a costs award made in the proceeding in the defendant's favour against a plaintiff who has received financial support from the Class Proceedings Fund in respect of the proceeding.

Pursuant to s. 59.4(3), a defendant who is entitled to make such an application may not recover any part of the costs award from the plaintiff.

The Class Proceedings Fund is intended to be self-perpetuating, and the statutory scheme is therefore designed so that funds are paid into the Fund in successful cases. In consideration for financial assistance and the assumption of risk of adverse costs awards, the *Class Proceedings Regulation* provides for a 10% levy payable in favour of the Class Proceeding Fund when a monetary award is made, or settlement reached, in favour of the plaintiff class in funded cases (reimbursement of any disbursement support received is also required in the event of success).[19]

The Class Proceedings Fund option is not, however, for everyone. The fixed levy may be perceived as a high price to pay for financial assistance. In addition, the Committee is not required to approve every application it receives, and has refused applications.[20]

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[19] *Law Society Act*, s. 59.5(1)(g) and Class Proceedings Regulation [Law Society Act], s. 10

[20] See *Law Foundation 2010 Annual Report, Book 3: Class Proceedings Fund*, online: <http://www.lawfoundation.on.ca/pdf/annual_reports/LFOAR2010_Book3.pdf>.

WHAT LESSONS HAVE WE LEARNED SO FAR ABOUT THIRD PARTY FUNDING?

A. LESSON #1: CHAMPERTY

Third party funding arrangements are not champertous per se *(but a cap on compensation is advisable)*

The early case law has established that third party funding agreements will not be rejected out of hand in Ontario, on the ground that they are *per se* a form of champerty.

Historically, the practice of financial assistance to litigants by non-parties has run up against the long-standing common law and statutory prohibitions against champerty and the broader concept of maintenance. The Court of Appeal has described these doctrines succinctly as follows:

> Maintenance 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.[21]

The interdiction against maintenance and champerty "played an important role in the common law in protecting the administration of justice from a variety of real or perceived abuses."[22] However, it is clear that courts will not view every instance of support by a non-party for the litigation of others as abusive. Rather, in order for there to be maintenance, an improper motive is required, and courts have validated conduct or arrangements based on the presence of a justifying motive or excuse.[23]

Indeed, the law's view of what constitutes an improper motive, and in turn, champerty and maintenance has evolved over time to accommodate "changing circumstances and the current

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

[22] *McIntyre Estate* at para. 23

[23] *McIntyre Estate* at paras. 27 ff. The court also made it clear that the statutory prohibition in *An Act Against Champerty*, R.S.O. 1897, c. 327 had to be interpreted in light of the common law understanding that an improper motive was required.

requirements for the proper administration of justice".[24] In the watershed case of *McIntyre Estate v Ontario (Attorney General)*, the Court of Appeal, citing a change in attitude tied to concerns about access to justice, held that contingency fee agreements between plaintiffs and their counsel should no longer be deemed *per se* champertous, but rather must be analyzed on a case by case basis to determine whether the agreement reflects an improper purpose (such as taking advantage of the client through overcompensation of the lawyer).[25]

Metzler Investment GmbH v Gildan Activewear Inc. was the first case in Ontario to consider a commercial third party funding agreement, and one of the issues before the court was whether the arrangement was champertous. In *Metzler*, the plaintiff brought a motion at an early stage of the proceeding seeking approval of an agreement with CFI. The agreement was described as a "Costs Indemnification Agreement", and its financial terms were that CFI would agree to pay any adverse costs award, in return for a commission in the event of success equal to 7% of any settlement or judgment amount (less fees, disbursements and administration expenses).[26]

As a preliminary matter, Justice Leitch was not prepared to make an order, prior to certification, binding class members to such an agreement (see lesson # 7, below). She proceeded, however, to determine whether the agreement should be approved as between the plaintiff and CFI. Justice Leitch applied the analysis in *McIntyre Estate* and held that third party funding agreements were not *per se* champertous, but that the court must look at the motivation behind the particular agreement.[27] Justice Leitch first observed that the "plaintiff is not impecunious and may well have the means to pursue litigation. However, I do not find it improper that it seeks to reduce the risks which a class proceeding exposes them to".[28] She then determined, analogizing the case with *McIntyre Estate*, that overcompensation for CFI would constitute an improper purpose, but that, since CFI's commission was tied exclusively to the monies recovered

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[24] *McIntyre Estate* at para. 32.

[25] *McIntyre Estate* at paras. 72 ff. As noted above, contingency fee arrangements were already permitted in the class action context, by statute: *CPA*, s. 33.

[26] *Metzler* at para. 12.

[27] *Metzler* at para. 63.

[28] *Metzler* at para. 67.

for class members, and was not capped, the reasonableness and fairness of the commission could not be assessed in advance.[29] In particular, she did not accept that this assessment was a matter best left to the plaintiff's business judgment, because it was not the plaintiff (or class counsel) who was assuming liability for the commission to CFI; rather, the commission would come out of the recovery of class members.[30] She therefore declined to declare, at that stage, that the agreement did not engage maintenance or champerty.[31]

In *Dugal*, the plaintiff similarly brought a motion early in the litigation to approve a funding agreement with CFI. Justice Strathy reviewed *McIntyre Estate* and *Metzler*, and agreed that "it would appear that exacting an unfair price for the funding agreement, with resulting unfairness to the litigant, would be an improper motive."[32] He was clearly satisfied that he could assess the propriety of the motive behind the agreement even though the matter was at an early stage. Importantly, unlike in *Metzler*, the agreement in *Dugal* provided, as noted above, for a cap on the potential compensation to CFI. Justice Strathy concluded first of all that the commission of 7% was generally reasonable and consistent with the commission that would be payable to the Class Proceedings Fund,[33] and secondly, that the cap on the commission ($5 million prior to pre-trial and $10 million thereafter) was reasonable and a fair reflection of the potential downside risk facing the funder. He observed that in the event of a substantial recovery at trial, the effect of the cap was that the commission could be substantially lower than that payable to the Class Proceedings Fund in similar circumstances.[34] He was also expressly influenced by the fact that the commission was not only acceptable to the plaintiffs, both of whom "can be fairly described

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[29] *Metzler* at para. 68 ff.

[30] *Metzler* at para. 70. Query, however, whether this consideration was relevant, given that the court had already concluded that a decision at this stage would not bind any class member other than the plaintiff.

[31] This decision was not the end of the matter. Justice Leitch later approved an amended agreement, in an unreported decision. However, on a motion for leave to appeal to the Divisional Court, Little J. expressed the view that there was good reason to doubt the conclusion of Leitch J. that third party funding agreements are not champertous *per se*: see *Dugal* at footnote 2.

[32] *Dugal* at para. 20.

[33] *Dugal* at para. 33(d).

[34] *Dugal* at para. 33(e).

as sophisticated investors" but also by a "large and reasonably representative cross-section of class members".[35]

Justice Strathy acknowledged that it could not be said with absolute certainty that the funding agreement would not result in a "windfall" recovery for CFI, but recognized that it was reasonable for a commercial risk-taker to insist on compensation that was commensurate with the risk of "protracted litigation and a somewhat speculative result".[36] Ultimately, he was not troubled by the prospect of approving such an agreement before the precise amount of compensation was known: "The assessment of 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."[37] His decision to approve the funding agreement in advance was no doubt driven in large part by his conclusion that it would help to promote access to justice, by alleviating the deterrence to the plaintiff and counsel arising from the prospect of a "crushing" costs award.[38]

Justice Strathy also noted that there was no evidence that CFI had stirred up, incited or provoked the litigation as contemplated by the *Champerty Act*, but rather that "the plaintiffs demonstrated a clear intention to proceed with the litigation before CFI came on the scene."[39] Further, he observed that the terms of the agreement left control of the litigation in the hands of the representative plaintiffs and did not permit "officious intermeddling" in the conduct of the litigation by the funder.[40]

In the result, Justice Strathy provisionally approved the funding agreement, subject to addressing certain specific concerns with its terms (see lessons #3 and #4, below).

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[35] *Dugal* at para. 33(f).

[36] *Dugal* at para. 33(g).

[37] Ibid.

[38] *Dugal* at para. 33(a).

[39] *Dugal* at para. 33(b)

[40] Ibid.

Fehr v Sun Life Assurance Company of Canada, a subsequent case, did not entail a decision on whether an agreement was champertous, and dealt primarily with the question of whether the law in Ontario requires that a motion for approval be brought, and if so, whether it need be on notice to the defendant (see lesson #6, below). However, in his reasons, Justice Perell reviewed the prior consideration of the champerty question and observed that "the current state of the law is that third party funding agreements are not categorically illegal but they may be".[41]

In *Labourers' Pension Fund*, Justice Perell considered an agreement with CFI that was nearly identical to that in *Dugal*. He repeated his conclusion from *Fehr* that "third party funding agreements are not categorically illegal on the grounds of champerty or maintenance, but a particular third party funding agreement might be illegal as champertous or on some other basis."[42] He gave brief reasons for approving the agreement, relying primarily on the reasons of Justice Strathy in *Dugal*. He concluded, among other things, that the agreement was fair and reasonable and facilitated access to justice.[43]

B. LESSON #2: FUNDERS' RIGHTS

Provisions permitting participation by the funder in the conduct of the litigation, or giving rise to an appearance of conflict of interest, are likely to be unenforceable

Separate and apart from the fairness and reasonableness of the fee, it remains a principal concern about third party funding agreements that a non-party with an interest in the outcome of litigation may seek to influence the conduct of the proceeding, and that a conflict may arise among the interests of the plaintiff, the funder and class counsel.

In *Metzler*, it is apparent that in drafting the agreement, efforts were made to balance the interest of the funder in being kept informed about the proceeding with the need to address the above-mentioned concerns. The agreement provided that the plaintiff irrevocably directed class counsel to advise CFI on significant issues in the action "such as prospects, strategy, quantum, proof and

[41] *Fehr* at para. 95.

[42] *Labourers' Pension Fund* at para. 12.

[43] *Labourers' Pension Fund* at para. 15.

any material change thereof" and "to promptly respond to any reasonable request by [CFI] of information". The agreement was explicit, however, that the plaintiff was to retain and provide instructions to class counsel, and that CFI was required to accept that class counsel's professional duties were owed to the plaintiff and not CFI.[44] Further, prior to the hearing, the plaintiff agreed to amend the agreement by deleting certain provisions giving CFI more input on the litigation, and others that effectively placed control of the litigation in the hands of class counsel.[45]

Nevertheless, Justice Leitch still required further amendments to the agreement. While accepting that the agreement did not restrict the plaintiff's ability to manage the litigation and that it did not give CFI the right to instruct class counsel or otherwise control the litigation, she disapproved of a provision requiring that a representative of CFI be invited to attend settlement discussions. She also held that the defendants were entitled to insist on the confidentiality of settlement discussions, and disallowed a provision requiring class counsel to immediately report to CFI on the details of such discussions.[46]

Justice Leitch also found fault with a provision that permitted CFI to terminate the agreement on seven days notice. She noted that CFI's withdrawal from the agreement would expose the plaintiff to an adverse costs award (and in turn class counsel, who had undertaken to the defendants to pay any final costs order not paid by the plaintiff within 60 days). While she accepted that CFI, the plaintiff and class counsel were aligned in interest in that all were advantaged by a higher award, she held that this termination provision created an appearance of conflict. She was clearly concerned that the spectre of unilateral withdrawal by CFI, and its attendant consequences for the plaintiff and class counsel, had the potential to give CFI an indirect influence over decision-making in the litigation "to fulfill its own motivations". She

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[44] *Metzler* at paras. 14-15.

[45] *Metzler* at para. 16.

[46] *Metzler* at paras. 58-59.

therefore required that the right of CFI to terminate its obligations be limited to circumstances where the plaintiff failed to fulfill its own obligations, or appointed different lawyers.[47]

Notably, the terms that Justice Leitch found objectionable were absent from the agreements later approved by the court in *Dugal* and *Labourers' Pension Fund* (although in *Dugal*, Justice Strathy approved a provision permitting the plaintiff to communicate to CFI any formal settlement offer made by the defendants, provided that those communications be kept confidential pursuant to the terms of the agreement.[48])

C. LESSON #3: CONFIDENTIALITY

Defendants are entitled to insist that there be reasonable controls on the provision of confidential information to the funder

In *Dugal*, Justice Strathy recognized that it was not unreasonable for the funder to require, for the management of its own affairs, information concerning class counsel's assessment of liability, damages and trial prospects, and concerning settlement offers. He acknowledged the defendants' concern, however, that the agreement did not provide adequate protection for confidential information obtained by plaintiffs' counsel. He therefore required as a condition of approval that appropriate guidelines be established "to recognize the interests of both CFI and the defendants."[49] In supplementary reasons, he approved terms that (a) require a defendant's consent before evidence obtained from that defendant is provided to CFI, and impose the deemed undertaking rule on CFI as if it were a party to the proceeding; and (b) as noted above, permit the plaintiff to communicate to CFI formal settlement offers by the defendants, provided they are kept confidential pursuant to the agreement.[50] (Identical terms were part of the order approving the agreement in *Labourers' Pension Fund*).

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[47] *Metzler* at para. 60.

[48] *Dugal (supplementary)*.

[49] *Dugal* at para 36.

[50] *Dugal (supplementary)*.

D. LESSON #4: SECURITY FOR COSTS

A funder without assets in Canada must be prepared to post security for costs

In *Dugal*, the defendants also raised the concern that CFI has no assets in Canada and had provided no evidence concerning its capacity to satisfy any costs award that may be made. Justice Strathy made his approval conditional on the provision of adequate security.[51] In supplementary reasons, he approved an arrangement whereby CFI would pay security into court in stages (an initial payment of $500,000; an additional $1,000,000 after certification; and a further $2,500,000 90 days prior to trial).[52]

In *Labourers' Pension Fund*, security was also ordered paid in stages (the amounts in that case were $750,000 initially; $1,500,000 after certification and $3,750,000 prior to trial). In approving the agreement, Justice Perell noted that the arrangement protected the interests of the defendants, observing that "the Defendants have the comfort that money for their legal costs has been paid into court."[53]

Strictly speaking, a defendant's right of recourse for costs is against the plaintiff, and the enforceability of any indemnity is a matter of concern for the plaintiff, who has the contractual relationship with the funder. It seems clear from these early cases, however, that courts are prepared to recognize the economic reality of class proceedings, in which plaintiffs may not have the assets necessary to satisfy an adverse costs award in the first instance, and, as a *quid pro quo* for approving funding, will require satisfaction that the indemnity can be honoured by the funder (indeed, the requirement for security may be as much about protecting plaintiffs who have entered into such agreements as it is about providing comfort to defendants).

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[51] *Dugal* at para. 35.

[52] *Dugal (supplementary)*.

[53] *Labourers' Pension Fund* at para. 15.

E. LESSON #5: PRIVILEGE

Third party funding arrangements are not privileged, or alternatively, any privilege is deemed waived

- ***Corollary lesson: agreements should not include information that discloses counsel's opinion about the merits, or detailed litigation strategy***

In *Fehr*, the plaintiffs sought an order that the motion for approval of their third party funding agreement with Bridgepoint be heard *ex parte* and *in camera*, primarily on the ground that the agreement was privileged. The plaintiffs argued that disclosing the contents of the agreement would reveal confidential and sensitive information regarding legal advice and litigation strategy (not to mention the resources available to prosecute the action and the plaintiffs' tolerance to risk).[54]

Justice Perell acknowledged Australian case law holding that a litigation funding agreement is privileged and should not be disclosed to an opponent.[55] He chose, however, not to adopt that position, at least in the context of class actions. After reviewing three "Canadian" arguments, he concluded that in Ontario, a third party funding agreement is not privileged, or if it is, the privilege is deemed waived.

First, he adopted the reasoning in *Fairview Donut Inc. v The TDL Group Corp.*, where Justice Strathy (in discussing the plaintiff's refusal to answer certain questions on cross-examination) concluded that disclosing details of who is funding the class action and on what terms does not involve the disclosure of solicitor-client communications.[56]

Second, Justice Perell concluded that even if a third party funding agreement is presumptively privileged because it relates to legal fees, that privilege is rebutted by the nature of the agreement. His analysis started with the established principle that the amount a client pays to his

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[54] *Fehr* at para. 3.

[55] *Re Global Medical Imaging Management Limited (in liquidation)*, [2001] NSWSC 476 at paras. 7-8; *Fehr* at para. 117.

[56] 2012 ONSC 152 at paras. 360-363; *Fehr* at para. 122-122.

or her lawyer for legal fees is presumptively covered by solicitor-client privilege. Justice Perell accepted that a third party funding agreement, because of its connection to legal fees and the lawyer's retainer, could presumptively attract solicitor-client privilege. He reasoned, however, that any such privilege is rebutted, because such an agreement does not (or at least ought not to) reveal, directly or indirectly, any solicitor-client communication that is protected by the privilege. Justice Perell emphasized that it would be both unnecessary and wrong to include information regarding counsel's view of the merits, or litigation strategy (beyond what would appear in a litigation plan).[57]

Finally, Justice Perell held that if a third party funding agreement is covered by privilege, fairness requires that the privilege be deemed waived. He observed that it was arguable that by applying for third party funding, a plaintiff puts in issue a number of questions about the resulting agreement that invite scrutiny, and noted that (as addressed more fully below) a defendant is affected by a third party funding agreement.[58]

F. LESSON #6: APPROVAL PROCESS

The plaintiff must obtain approval for the third party funding agreement, on notice to the defendant, and in open court

In all of the reported cases so far, it has been a term of the arrangement that court approval would be sought. If there was any doubt that approval is, in any event, a prerequisite to enforceability of an agreement, that doubt has been removed by *Fehr*. *Fehr* has also made it clear that any approval motion must be on notice to the defendant, and open to the public. Justice Perell declared unequivocally in *Fehr* that "a third party funding agreement must be promptly disclosed to the court and the agreement cannot come into force without court approval. Third party funding of a class proceeding must be transparent and it must be reviewed in order to ensure that there are no abuses or interference with the administration of justice. The propriety of third party

[57] *Fehr* at paras. 123-136.

[58] *Fehr* at paras. 137-140.

funding agreements is controversial and problematic and, in my opinion, at a minimum, they should not be allowed to operate clandestinely."[59]

Fehr was the first and so far only case in which these questions have been considered on a contested basis. In *Metzler*, the plaintiff had originally intended to seek approval on an *ex parte* basis, taking the position that the defendants were not "affected" by the motion in the manner contemplated by the rules governing notice. Once the defendants became aware of the motion and took the contrary position, however, the plaintiffs conceded the point. Justice Leitch commented that it was appropriate to do so, because in her view the terms of the agreement affected the defendants and they were entitled to participate in the motion.[60] Similarly, in *Dugal*, the motion was brought on notice and the defendant's participation was not contested, but in the course of his reasons, Justice Strathy made the observation that the agreement had implications for the defendants.[61] (*Labourers' Pension Fund* also proceeded on notice to the defendant).

In *Fehr*, the issue was squarely before the court. As noted above, the plaintiffs were seeking an order that the approval motion be heard *ex parte* and *in camera*, and that the file be sealed. The defendant, Sun Life, opposed this request, and wanted to participate in any funding approval motion. Sun Life argued that it had an interest in ensuring that (a) the third party funder is financially capable of honouring its commitments; (b) that the funder's commitment to pay an adverse costs award is directly enforceable by Sun Life; (c) that the implied undertaking applies to the funder; and (d) that the integrity of the litigation process and the administration of justice is maintained.[62]

Justice Perell agreed that Sun Life was affected by the motion. He further observed that in any event, "as a policy matter a defendant's participation would be useful and should be permitted."[63]

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[59] *Fehr* at paras. 89-90.

[60] *Metzler* at para. 3.

[61] *Dugal* at para. 16.

[62] *Fehr* at para. 106.

[63] *Fehr* at paras. 108-109.

He accepted that a third party funding agreement might raise a range of issues that should be addressed by the court. In his view, it would be useful to have full argument from both parties on any such issues or, in cases where a defendant supports or does not oppose third party funding, to understand why.[64]

He also rejected the plaintiffs' argument that a motion for funding approval should unfold away from public view. He reviewed the law regarding the open court principle, and concluded that the plaintiffs had failed to establish the necessary elements to depart from that principle. He did not accept that an open process would pose a serious risk to the administration of justice, given his conclusion on the question of privilege (he also observed that the risk that the approval motion would be withdrawn – thereby jeopardizing the viability of the plaintiffs' action – if the agreement had to be disclosed, was a "self-inflicted risk", and remarked that if Bridgepoint "does not wish to disclose its pecuniary interest in the litigation, then Bridgepoint should do its business in another less transparent or more disinterested forum"). He found in the alternative that there were other means, short of the order sought, of preventing any risk to the administration of justice, and in any event, the deleterious effects of an order restricting the open court principle would outweigh any benefit.[65]

G. LESSON #7: APPROVAL TIMING

Approval motions can and should be brought prior to certification (and prior to leave under Part XXIII.1 of the Securities Act*)*

- ***Corollary lesson: evidence that a cross-section of prospective class members has been canvassed on the agreement can be useful, but is not a* sine qua non *of approval***

In *Metzler*, Justice Leitch concluded that although the court has broad discretionary jurisdiction under s.12 of the *CPA* to make orders respecting the conduct of a class proceeding, the court should not exercise that discretion to make the agreement binding on class members at a time when the action has not been certified and class members have not had the opportunity to have

[64] *Fehr* at paras. 110-111.

[65] *Fehr* at paras. 142-159.

their views presented.[66] She was not swayed by the argument that plaintiffs face the greatest risk of adverse costs at the leave and certification stages of securities class actions, and that deferring the approval motion until after the leave and certification motions "is akin to rejecting it".[67]

In *Dugal*, in contrast, Justice Strathy concluded that the court should exercise its jurisdiction to approve the agreement prior to certification. He reasoned as follows at para. 17:

> A part of the court's responsibility in class actions is to protect the rights of prospective class members. One of the most important of those rights is the right to advance a class proceeding. To postpone the decision to post-certification, when the views of class members can be sought, could very well spell the end of this proceeding, because the plaintiffs cannot withstand an adverse costs award on certification. In my view, exercising the Court's supervisory jurisdiction over the proceeding, I am entitled to put myself in the shoes of prospective class members and ask whether the proposed agreement is fair and reasonable.

Notably, Justice Strathy had the benefit in *Dugal* of knowing that a cross-section of class members had been given notice of the agreement (which the plaintiffs' counsel had done in an effort to address the concerns of Justice Leitch). It seems clear that Justice Strathy did not want to impose such notice as a pre-requisite to approval, but that it may nevertheless improve a plaintiff's chances. He acknowledged that while "[t]he fact that it is acceptable to a reasonably representative and informed group of prospective class members is by no means determinative", it was "an important factor I have considered in coming to this conclusion".[68] (Similarly, in *Labourers' Pension Fund*, Justice Perell noted that notice was given to Sino-Forest's 20 largest independently-run institutional investors, and that there was no opposition to approval,[69] but did not suggest that such notice was a pre-requisite).

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[66] *Metzler* at para. 28.

[67] *Metzler* at para. 23.

[68] *Dugal* at paras. 15 and 17.

[69] *Labourers' Pension Fund* at paras. 7-8.

In *Fehr*, Justice Perell agreed with Justice Strathy's analysis in *Dugal*, and went a step further, ruling, as noted above, that the third party funding agreement must be "promptly" disclosed to the court so that it can be reviewed. For his part, he observed that class members are already protected from exposure to adverse costs awards. While he acknowledged that class members were affected in some respects by third party funding agreements, including the extent of the funder's commission, he noted that "it would be for the court to determine whether the third party funding agreement is fair to the persons who would be bound by it." He did not see any reason that would justify postponing making a binding decision until after certification.[70]

H. LESSON #8: KNOWN UNKNOWNS

There remains uncharted territory in the law of third party funding

In the words of Justice Perell, "It is early days for third party funding motions."[71] It has become clear that there are a number of questions that will have to wait to be addressed in future cases, or by legislation (so far, regulation in this area has been limited to court supervision, but it is not impossible to conceive of an eventual statutory framework).

Regulatory issues

In *Fehr*, Sun Life identified a number of substantive questions that a third party funding agreement might raise, but which to date have not been considered by a court in Ontario. For example:

- Whether the third party agreement might be "legal expense insurance," in which case it would be regulated under the *Insurance Act*, and the court would have to consider whether the agreement complied with the Act. The court would also have to consider whether notice of the motion should be given to the regulator, the Financial Services Commission of Ontario.

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[70] *Fehr* at para. 93.

[71] *Fehr* at para. 163.

- Whether the third party funding agreement involved an investment scheme, in which case it might be a "security" subject to compliance with the *Securities Act*.

- Whether the third party funding agreement might be illegal under s. 347 of the *Criminal Code* for imposing a criminal rate of interest.[72]

If the Australian experience is any indication, these are not left-field considerations. In 2009, the Federal Court of Australia found that a funding arrangement constituted an unregistered managed investment scheme. The government responded by implementing a regulatory carve-out for funded class actions.[73] Subsequently, in 2011, the New South Wales Court of Appeal found that a funding agreement was a "financial product" requiring the funder to hold a financial services licence.[74]

Procedural questions

In *Fehr*, Justice Perell also noted that "it will take some experience" to develop the procedural parameters for approval motions. Although he ultimately held that defendants should be entitled to participate in such motions, he acknowledged that "there are aspects of a funding application that should be none of the defendant's business"; for example, "it is no business of the defendant to inquire into how the Plaintiffs would propose to use the funding for the purposes of the litigation". He observed therefore that "the normal rules about motions may need to be adjusted". For the case before him, he ordered, among other things, that there would be no cross-examinations on the motion without leave of the court.[75] Further rules pertinent to contested

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[72] *Fehr* at para. 108.

[73] *Brookfield Multiplex Ltd v International Litigation Funding Partners Pte Ltd* (2009) 256 ALR 427; *Brookfield Multiplex Ltd v International Litigation Funding Partners Pte Ltd* [2009] FCAFC 147. See Law Council of Australia, *Regulation of third party litigation funding in Australia*, June 2011, online: http://www.lawcouncil.asn.au/shadomx/apps/fms/fmsdownload.cfm?file_uuid=FDE54AA6-C860-A078-ED07-5BB15F2A31E3&siteName=lca at pp. 13-15.

[74] *International Litigation Partners Pte Ltd v Chameleon Mining NL* [2011] NSWCA 50. See Law Council of Australia, supra note 73 at p. 15.

[75] *Fehr* at para. 161-162.

motions may or may not be necessary; as the law evolves, it is possible that eventually, standard provisions will be developed, and opposition to such agreements will not materialize.

Permissible scope of funding arrangements

As noted above, to date, there are only two reported cases in which agreements have been approved, and both contained similar terms. The full range of possible funding arrangements has not yet been considered. For example, to date there have been no disclosed agreements in Ontario contemplating payment of plaintiffs' counsel's fees on an ongoing basis. As noted above, in theory funders stand ready to provide this type of assistance. As a practical matter, it may or may not be a realistic possibility in Ontario; for one thing, it substantially increases the risk to the funder. However, assuming acceptable terms could be negotiated, it is an open question whether a court would approve them. It is not clear how such an agreement would interact with class counsel's own fee agreement with the plaintiff, approval of which is required by s. 32 of the *CPA*.

The limits of permissible commissions also have yet to be tested – one day, for example, a court may be asked: if the Class Proceedings Fund is entitled to 10%, why not a commercial funder?

Standing of the funder in costs determinations

Finally, a question that will eventually have to be addressed is what role, if any, a funder will be permitted to play in costs submissions where the plaintiff is unsuccessful. Under the regime governing the Class Proceedings Fund, the Law Foundation of Ontario is entitled to notice and to make submissions (and even present evidence) on costs, in cases where the court is of the view that a defendant may be entitled to an award of costs.[76] A funder could argue that, as the ultimate payer of any costs, it has a similar interest in having independent standing at a costs hearing. If this standing is not granted by the court, then funders may begin to seek

[76] Rule 12.04(2)-(3) of the *Rules of Civil Procedure*.

commitments from plaintiffs to make submissions on costs, on behalf of the funder, where required.