WeirFoulds LLP

# Three's Company or Three's a Crowd? Recent Guidance from the Courts on Third-Party Funding of Litigation

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**Overview**

Third-party funding of litigation is a relatively new phenomenon in Canada. Under this type of funding arrangement, a third-party lender agrees to advance funds to a litigant, subject to terms and conditions, usually in exchange for a certain percentage of any amount that is recovered through settlement or after a judgment. As courts have recognized, these types of arrangements have the potential to increase access to justice by providing litigants who do not have access to significant capital with access to important resources and tools that may facilitate their ability to fully advance the merits of their claims. From a commercial perspective, these types of third-party funding arrangements could open up a whole new market for investment opportunities.

However, third-party funding of litigation continues to run up against the ancient (though still relevant) legal doctrine of champerty. The elements of a claim of champerty are: (1) the defendant provides assistance to a litigant for an improper motive (officious intermeddling); (2) the defendant has no personal interest in the lawsuit; (3) the defendant's assistance to the litigant is without justification or excuse; and (4) the defendant shares in the spoils of the litigation.[1] Up until 2002, third-party funding agreements were *per se* illegal as being champertous. This changed with the Court of Appeal's decision in ***McIntyre Estate v Ontario (Attorney General)***, which recognized that a person supporting another's litigation might be justifiable and does not necessarily constitute officious intermeddling.[2] Since that time, case law involving contingency agreements and third-party funding agreements has been slowly developing the common law of champerty, adapting it to modern funding arrangements.

How the law of champerty continues to develop in response to third-party funding agreements will shape the ability of the market for third-party funding to grow (or wilt) in Canada.

The recent case of ***Houle v St. Jude Medical Inc.***[3] highlights the tensions that remain between what may be commercially reasonable and what the courts may be willing to accept when it comes to third-party funding agreements. This case provides a caution but also some helpful guidance to companies and investors seeking to get involved in third-party funding of litigation, and to parties seeking third-party litigation funding.

**The Proposed Class Action and the Third-Party Funding Agreement**

*Houle v St. Jude Medical Inc.* is a proposed class action brought by Shirley and Ronald Houle, as representative plaintiffs, against St. Jude Medical Inc. and St. Jude Medical Canada, Inc. (collectively "**St. Jude**"). regarding defective defibrillators which St. Jude had manufactured and which had been implanted in thousands of Canadians. The proposed class action relates to claims of negligence and failure to warn. The Houles retained class counsel to act in the proposed class action, and signed a retainer agreement (the "**Retainer Agreement**") which included a contingency fee arrangement whereby class counsel would receive 33% of any amounts recovered against St. Jude. However, class counsel were not prepared to provide an indemnity to the Houles for any potential adverse costs award.  Neither were they willing to cover the costs of disbursements for the action (which, due to the required expert evidence,

among other things, were expected to be substantial). As part of the Retainer Agreement, the Houles instructed class counsel to obtain funding either from the Class Proceedings Fund or a third-party funder.

Class counsel approached a company called Bentham IMF, which specializes in litigation funding, about obtaining third-party funding for the proposed class action. The Houles, class counsel and Bentham IMF signed a Litigation Funding Agreement which provided the following, *inter alia*:

- Bentham will pay all disbursements incurred by class counsel, up to a prescribed maximum amount;
- Bentham will pay any costs awarded against the Houles, as well as any security for costs;
- Bentham will pay 50% of class counsel's docketed time up to a prescribed maximum amount;
- In exchange, Bentham will receive 20%, 22.5% or 25% of any amounts recovered, depending on the stage at which the action is resolved;
- Class counsel will receive 10%, 11.5% or 13% of the proceeds, depending on the stage at which the action settles (in addition to the 50% of their docketed time as paid by Bentham);
- The agreement contains several sections relating to the conduct and management of the litigation, including obligations to undertake the litigation in an efficient, affordable and proportionate manner;
- Bentham has the right to terminate the agreement, in its sole discretion, if, among other things, Bentham "ceases to be satisfied in relation to the merits of the proceedings" or "Bentham reasonably believes the Proceedings or the Claims are no longer commercially viable".

This was a novel kind of third-party funding agreement because it created a hybrid retainer that combined a fee-for-services agreement with a contingency fee arrangement for class counsel. This third-party funding agreement was also novel because it provided that the third-party funder would receive a larger share of the proceeds than class counsel, and that share was a larger share than courts had ever approved before for a third-party funder.

**Justice Perell Approves the Agreement subject to Conditions**

The parties applied to the court for approval of this Litigation Funding Agreement. Justice Perell reviewed the law of champerty as it had been applied in the context of contingency fee agreements and, more recently, in the new context of third-party funding agreements.[4] Based on the case law, Justice Perell identified six factors to be considered when court approval of a third-party funding agreement is sought:

1. procedural, technical and evidentiary requirements: (a) the litigant has received independent legal advice with respect to the agreement; (b) the retainer and third-party funding agreements have been disclosed to the court; (c) the retainer and third-party funding agreements have been disclosed to the defendant, with appropriate redactions; (d) there are appropriate confidentiality provisions in the third-party funding agreement; (e) the third-party funder is willing and able to post security for costs; (f) evidence of the background and factual circumstances has been put forward; and (g) the affected parties have all been given notice and an opportunity to be heard;[5]
2. necessity: third-party funding is necessary either because without such funding, the litigant would have no access to justice, or without the third-party assistance, society would be bereft of a means to deter wrongdoing; Justice Perell called this the "paramount factor";[6]
3. sufficiency: third-party funding must actually make a meaningful contribution to access to justice or deterrence of wrongdoing/behaviour modification;[7]
4. the third-party funder must not be unduly rewarded or overcompensated – in some cases, this cannot be assessed until the outcome of the litigation is known;[8]
5. the third-party funding agreement must not interfere with the lawyer-client relationship, the lawyer's duties, or the lawyer's professional judgment and carriage of the litigation on behalf of the plaintiff;[9]

6. the agreement must not be illegal on some independent basis (aside from champerty).[10]

Justice Perell found that the Houles' Litigation Funding Agreement did not satisfy the fourth and fifth factors. Because Bentham's recovery was uncapped, it was not possible to say in advance whether the eventual value of its contingency fee would be unfair or disproportionate. To resolve this, Justice Perell imposed a condition that 10% of Bentham's contingency fee would be pre-approved, with the remainder to be subject to subsequent court approval.[11] With regard to the fifth factor, Justice Perell found that the litigation management provisions were overly broad and intrusive, giving Bentham broad contractual rights to control the litigation despite the fact that the Houles and the class members were genuine plaintiffs who should be permitted to control their own litigation.[12] Further, because Bentham had sole discretion to trigger the termination of the agreement based on its subjective view of the litigation under the termination provision of the Litigation Funding Agreement, Justice Perell found that this effectively allowed Bentham to control the litigation. Justice Perell ordered many of these clauses to be deleted and replaced. With regard to the termination provisions in particular, Justice Perell ordered that any termination would have to be subject to court approval.[13]

**The Appeal**

The third-party funder, class counsel and the Houles were unwilling to make the changes which Justice Perell's conditional order required and sought to appeal the order in order to avoid having to terminate the third-party funding agreement.

An appeal of this order was initially brought to the Court of Appeal, with the Houles, class counsel and Bentham arguing that it was a final order appealable to the Court of Appeal rather than an interlocutory order appealable to the Divisional Court with leave. The Court of Appeal quashed the appeal, holding that an order for approval of a funding agreement was interlocutory and did not finally dispose of the rights between the parties.[14]

An appeal with leave was then heard by the Divisional Court. Justice Myers, writing for the Court, held that Justice Perell had made no error in principle and that the Court agreed with his approach.[15] There are four main takeaways from the Divisional Court's decision:

1. Justice Perell's statement that necessity is the "paramount factor" is *obiter* and whether this factor is, in fact, paramount will have to await a case where the presence or lack of necessity factors into the outcome of the case;[16]
2. The Divisional Court agreed with Justice Perell's decision to approve a 10% contingency fee in advance, while making the remainder of any fee subject to court approval. The Houles and Bentham argued that Justice Perell had erred in comparing a third-party funder to the Class Proceedings Fund or to class counsel – because Bentham was taking on much greater risk than the Class Proceedings Fund and because Bentham, as a lender, should not have its remuneration compared to a lawyer whose remuneration is assessed based on services provided. The appellants also argued that Justice Perell had failed to respect the fact that the parties had made a commercial decision at arm's length and with appropriate legal advice. The Divisional Court held that unlike other commercial agreements, the fundamental need to protect the administration of justice requires the court to have oversight and weigh in on third-party funding agreements. Further, the court held that it is appropriate to wait to determine the reasonableness of an uncapped contingency fee for a third-party lender until the outcome of the litigation.[17]
3. The Divisional Court agreed with Justice Perell's decision to make termination of the Litigation Funding Agreement subject to court approval. The broad and subjective termination rights contained in the agreement prevented adequate oversight by the courts.[18]
4. The Divisional Court was not willing to limit Justice Perell's decision to class actions. Whether Justice Perell's approach to the assessment of third-party funding agreements applies in contexts other than class actions will have to be determined if and when such cases arise.[19]

**Conclusion**

Companies engaged in third-party litigation funding and parties seeking third-party funding should take note of the decisions in *Houle*. First and foremost, they must be aware that third-party funding agreements will be subject to court oversight based on the policy objective of protecting the administration of justice. Broadly drafted and subjective termination clauses, like the one present in *Houle*, are unlikely to stand up to judicial scrutiny. In addition, where the third-party funders' recovery is uncapped, a court may not be willing to pre-approve such a contingency fee. Finally, third-party funders and plaintiffs must also ensure that all the procedural requirements identified by Justice Perell (such as independent legal advice) are met.

While Ontario courts have opened up the possibility of third-party funding agreements in recent years, the law of champerty still imposes significant restrictions that may affect the level of risk that third-party funders are prepared to take given the uncertain level of compensation that a court is willing to approve.

[1] *Houle v St. Jude Medical Inc.*, 2017 ONSC 5129 at para 51 ("**Houle (SCJ)**").

[2] *McIntyre Estate v Ontario (Attorney General)*, (2002) 61 OR (3d) 257 (CA), as cited in Houle (SCJ) at para 53.

[3] *Houle v St. Jude Medical Inc.*, 2018 ONSC 6352 ("**Houle (Div Ct)**").

[4] Houle (SCJ) at paras 53-70.

[5] Houle (SCJ) at paras 73-74.

[6] Houle (SCJ) at para 75.

[7] Houle (SCJ) at para 78.

[8] Houle (SCJ) at paras 80-82.

[9] Houle (SCJ) at para 88.

[10] Houle (SCJ) at para 100.

[11] Houle (SCJ) at paras 85-87.

[12] Houle (SCJ) at paras 93-94

[13] Houle (SCJ) at paras 96-98

[14] 2018 ONCA 88.

[15] Houle (Div Ct) at para 7.

[16] Houle (Div Ct) at para 31.

[17] Houle (Div Ct) at paras 37-44.

[18] Houle (Div Ct) at paras 45-46.

[19] Houle (Div Ct) at para 54.

***The information and comments herein are for the general information of the reader and are not intended as advice or opinion to be relied upon in relation to any particular circumstances. For particular application of the law to specific situations, the reader should seek professional advice.***

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