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Justice for Profit: A Comparative Analysis of Australian, Canadian and U.S. Third Party Litigation Funding

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“Third-party funding undermines the civil justice system. [...] Do we really want [funders] in our civil justice systems to commercialise the practice of law? We are moving from being a profession into being an investment entity.”

“For us to have access to fairly priced funding would enormously improve access to justice.”

I. Introduction

In many parts of the world, third party litigation funding (TPLF) has emerged as one of the most significant developments in civil litigation today. It has been identified by the UCLA-RAND Institute for Civil Justice as one of the “biggest and most influential trends in civil justice.” In England, Germany, Australia and the U.S., the topic has received significant attention by regulators, the media and the legal profession. Opponents have called for the banning or heavy regulation of such activity, on the basis that it gives rise to substantial risk of litigation abuse, particularly in the context of class or mass actions. Supporters, citing the need to increase access to the courts and level the playing field between plaintiffs and well-resourced defendants, have blessed TPLF, albeit with a caution that “the practice can pose thorny ethical issues.”

Much more recently, TPLF has also captured the attention of the bar and judiciary in Canada. Justice Strathy’s approval of a third party funding agreement in the Dugal class action attracted much attention and some controversy. While the UK and Australian

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1 Jonathan Ames, “Litigation financing 'needs crackdown”’ The Times (London) (11 December 2011) p. 66, quoting Lisa Rickard of the U.S. Chamber of Commerce’s Institute for Legal Reform. Rickard and other top officials from the Institute were in England last December to press the Justice Minister and the Lord Chancellor to reject the liberalization of commercial funding, especially in multi-party litigation.

2 Margaret McCaffery, “Litigation as an asset class” National Post (26 March 2008) FP8, quoting Joe Groia, securities litigator and member of the plaintiff-side class action bar in Ontario.

3 Third party litigation funding is the commercial financing of an individual or portfolio of lawsuits by a person or entity that is not a party to the litigation itself. Although contingency fees and insurance coverage also constitute forms of funding by non-parties, we use the term TPLF in this paper to connote funding provided by firms on a non-recourse basis, in exchange for a share of the settlement or judgment proceeds. In the literature, TPLF is also referred to as litigation finance and commercial litigation funding.


5 U.S. Chamber Institute for Legal Reform, “Selling Lawsuits, Buying Trouble: TPLF in the United States” (October 2009) [Selling Lawsuits, Buying Trouble].


governments ponder potential statutory regulation of the industry, and the American Bar Association and other state bars examine the ethical implications of litigation financing, the issue has received little regulatory attention in Canada. In all of these jurisdictions, however, the debate is typically the same and is captured by the quotations that preface this article: is commercial funding a boon for access to justice, or is it a commodification of litigation? Can it be both?

Many academics, lawyers and funders have entered the fray on these important policy questions within their own jurisdictions. Courts and policymakers in several countries are also looking to each other as they debate these questions. In U.S. and Canadian commentary, Australia’s two-decade history with TPLF is routinely cited in support of the growing TPLF industry in their own jurisdictions. In Australia, the *Dugal* decision may soon be relied upon to support a proposed expansion of funding arrangements in class actions. All three jurisdictions serve as both useful precedents and cautionary tales for UK leaders currently examining the adequacy of the self-regulation model for third party funders.8

Such cross-pollination in the public and jurisprudential debates on TPLF can be enormously helpful, but must be approached with caution. The TPLF industry operates in very different procedural environments. Any comparative analysis must take into account the various jurisdictions’ unique litigation culture and architecture. The commercial funding industries in each country do not necessarily have a shared pedigree, nor do they operate in an identical manner. Nevertheless, there may be common practices and ethical challenges associated with commercial funding of litigation that can be usefully examined in a comparative exercise.

In this paper, we explore three of the main jurisdictions in which TPLF of litigation has emerged: Australia, the U.S. and Canada.10 While there is a sizeable body of literature in each of these jurisdictions on their respective TPLF practices, this paper uniquely examines these three countries’ TPLF regimes in comparative perspective. We start our survey of TPLF in Australia, where the industry has the longest history and is well-entrenched. In successive parts of this paper, taking each jurisdiction in turn, we examine the historical development of TPLF, current practices, the legal and procedural context within which such

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9 A voluntary code of conduct was proposed by the UK Civil Justice Council in November 2011. See The Association of Litigation Funders of England and Wales, *Code of Conduct for Litigation Funders* (November 2011): http://www.calunius.com/media/2540/alf%20code%20of%20practice.pdf. Within less than two months, however, the government announced that it would introduce statutory regulation of the TPLF industry. See “Government to consider tightening up referral fee ban and regulating third-party funding” Legal Futures (2 February 2012), online: http://www.legalfutures.co.uk/latest-news/government-to-consider-tightening-up-referral-fee-ban-and-regulating-third-party-funding.

10 For a comprehensive discussion of the status of litigation funding in the UK, with references to other jurisdictions, see Christopher Hodges, John Peysner and Angus Nurse, “Litigation Funding: Status and Issues” (January 2012), online: http://www.csls.ox.ac.uk/documents/ReportonLitigationFunding.pdf.
funding takes place, and how each jurisdiction is addressing regulation of this form of finance. Throughout, we pay particular attention to class action financing. Although our initial goal was to focus exclusively on class action litigation (where commercial funding is most controversial in some quarters), our research revealed that funders have not penetrated the U.S. class action market to any significant degree. Nevertheless, there are signs that this may change. Consequently, our discussion of the U.S. TPLF landscape will focus upon existing practices and challenges, and will explore the competing views about the viability and desirability of commercially funded class actions. In the final part of the paper, we engage in a comparative analysis of TPLF in the three countries, and highlight important differences that may ultimately result in unique approaches to regulatory oversight of the industry.

II. Australia

Commercial litigation funding is a substantial and growing industry in Australia. In its early years, TPLF invested primarily in insolvency cases. In the last decade, funders have expanded their business to include large class actions, especially securities cases. At present, there are at least five commercial litigation funders operating. The largest, IMF (Australia) Ltd, is a publicly listed company providing funding for litigation and other related services in Australia and in other jurisdictions. It has explored funding in Europe and has recently opened a New York office.

In Australia, the threshold for claims funded by IMF must be over AU$ 5 million. IMF was the first litigation funder in Australia to be listed on the Australian Stock Exchange. Extensive information about the company and present and previously funded cases is available on its website. Although IMF does not limit its funding to class actions, this has been a major focus of its investment portfolio to date.

In its ten-year period of operation in the relatively small Australian market, 130 cases funded by IMF have been commenced and completed, resulting in a recovery of approximately AU$ 1 billion on behalf of claimants (including legal fees and expenses recovered). Funded clients have received a net amount of approximately AU$681 million; IMF has received approximately AU$ 325 million (including costs recovered) and legal fees and expenses paid to firms handling funded cases have totalled approximately AU$ 105 million. The net income to IMF was approximately AU$ 220 million. As at 31 December


13 In the period 19 October 2001 to 31 December 2011, 130 funded cases had been completed. Of these 89 (68%) had settled; 12 (9%) had succeeded at trial; 4 (3%) had lost at trial; and 25 (19%) had been withdrawn.
2011 the estimated value of the claims in the 27 cases being funded by IMF at that time was AU$1.6 billion.\textsuperscript{14}

In pure dollars, the bulk of commercial funding in Australia is now concentrated in class action litigation. Most judicial and regulatory attention regarding the industry has arisen in the class action context. Although the cost-shifting rule and lack of legal aid funding are the impetus for TPLF in both class action and individual plaintiff litigation, the magnitude of, and the additional structural barriers that arise in, class actions amplify the attendant concerns and benefits of this form of financing.

\textbf{a. Origins of Litigation Funding}\textsuperscript{15}

In recent years there has been a substantial decline in the availability of legal aid in civil cases as a result of a reduction in funding by both federal and state governments. Moreover, Australian class action litigation has been bedeviled with funding and financing difficulties since the introduction of statutory ‘opt out’ class action procedures.

At present there are three main statutory class action regimes in Australia. In the Federal Court class actions are governed by Part IVA of the \textit{Federal Court of Australia Act 1976} (Cth). In the Supreme Court of Victoria similar provisions have been adopted in Part 4A of the \textit{Supreme Court Act 1986} (Vic). In New South Wales class actions may be conducted in the Supreme Court pursuant to the provisions of the \textit{Civil Procedure Act 2005} (NSW).\textsuperscript{16}

The statutory class action procedures in Australia are analogous to those in the United States and Canada. However, one major difference is that there is no ‘certification’ stage. An action may be commenced and conducted as a class action without seeking the imprimatur of the court. If the defendant wishes to contend that the case should not be permitted to proceed in class action form, either because the statutory threshold criteria are not satisfied, or on other grounds, the onus is on the defendant to take steps to have this determined by the court.

The funding difficulties in class action litigation in Australia relate to both the means of financing the conduct of proceedings and the vexed issue of potential liability for adverse

\textsuperscript{14} We are grateful to John Walker, Director and Diane Jones, Chief Operating Officer at IMF (Australia) Ltd for supplying updated financial information as at 30 April, 2012.

\textsuperscript{15} Part of the Australian section of this article has been adapted from a paper by Peter Cashman and Jasminka Kalajdzic 'Funding Shareholder Class Action Litigation: Can A Litigation Funder (Or Lawyer) Obtain An Order For The Payment Of A Share Of The Proceeds Of Recovery Payable To Group Members In An 'Opt Out' Class Action Without The Individual Consent Of Such Group Members' presented at the 2011 IMF (Australia) Ltd Shareholder Class Action Conference Radisson Blu Plaza Hotel, Sydney, 17 November 2011. Very helpful comments on a draft of that paper were received from John Walker of IMF; Professor Vince Morabito of Monash University; Ben Slade of Maurice Blackburn; Professor Rachael Mulheron of Queen Mary, University of London; Emeritus Professor Garry Watson of York University, Ontario and Lachlan Armstrong of the Victorian Bar. Mark Leeming SC of the Sydney Bar provided some helpful information on equitable principles.

legal costs in the event that the class action is unsuccessful. In most areas of civil litigation in Australia, including in class actions, the loser will usually be ordered to pay some or all of the legal costs and other expenses incurred by the winning party. In each Australian jurisdiction, class members who are not representative parties or sub-group representatives, have statutory immunity from having to pay any part of the costs ordered to be paid by the representative party.

The Australian Law Reform Commission recognized the potential difficulties this creates in the area of class actions and recommended that contingency fees be permitted and a class action fund introduced. The proposed fund was modeled in part on the two class action funds in Canada.\(^{17}\) These recommendations were not taken up by the Australian Parliament.\(^{18}\) A similar proposal for a statutory fund (the ‘Justice Fund’), to be funded by way of a percentage of the recovery in successful cases and subject to a cap on adverse costs, was recommended by the Victorian Law Reform Commission.\(^{19}\) Although the Victorian Labor Government at the time expressed support for the Commission’s report, only some of the wide ranging recommendations were implemented before the Government lost office. The Justice Fund was not amongst them.

The statutory immunity of class action members from costs orders places the representative party (and a successful respondent) in an invidious position. Because a representative party is potentially liable for the costs of an unsuccessful action (or the costs of part of the action even where there is a successful outcome\(^{20}\)) there is a considerable disincentive, and no financial incentive, to take on the role of being a representative party.

In Federal proceedings at least, any legislative constraint on the recovery of costs against a legally aided representative party arising pursuant to state legal aid legislation\(^{21}\) is inapplicable. In any event, due to budgetary constraints and the dramatic cuts in federal funding of legal aid, it is presently unrealistic to expect any Australian legal aid authority to provide adequate funding or adverse costs protection in class action proceedings.

The successful respondent in a class action is also in an invidious position because if the action fails (in whole or in part) any costs order would normally be made only against

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\(^{17}\) Public funding to plaintiffs is available in Ontario by way of the Class Proceedings Fund, and in Quebec via the *Fond*. For a general discussion of these two funds, see J. Kalajdzic, W.A. Bogart and Ian Matthews, “Class Actions in Canada: Country Report Prepared for the Globalization of Class Actions Conference” (2009) 622 Annals of the American Academy of Political and Social Sciences 41-52.

\(^{18}\) See *Senate Debates* 12 September 1991 at 1448. The Commission did not recommend percentage based fees but was of the view that a higher than ‘normal’ fee should be permitted to compensate for the risk.


\(^{20}\) See e.g. *Peterson v Merck Sharpe & Dohme (Aust) Pty Ltd (No 5) [2010] FCA 605* (18 June 2010). The primary judgment on liability was overturned on appeal and the application for Special Leave to the High Court has been recently refused.

\(^{21}\) See e.g. s 47 *Legal Aid Commission Act 1979* (NSW)
the unsuccessful representative party who may not have the financial means to pay the amount required.

b. Current Funding Options

In the absence of some form of statutory fund there are nine options for the financing of class action litigation in Australia:

(a) funding and/or adverse costs indemnity by class members themselves;

(b) funding and/or costs indemnity by the law firm(s) conducting the proceeding;

(c) funding and/or costs indemnity by legal aid authorities;

(d) funding and/or costs indemnity by a third party on a philanthropic (non profit) basis;

(e) third party funding and/or costs indemnity by a commercial party or entity for profit;

(f) funding and/or costs indemnity by an organization (e.g. a trade union22) of which the class members are a part;

(g) the conduct of class actions by regulators that have statutory authority to bring proceedings on behalf of those who have suffered or who are likely to suffer loss or damage;23

(h) costs indemnity through ‘after the event’ insurance;

(i) funding by insurers in the exercise of their rights of subrogation to recover for losses paid out for disasters, such as bushfires and floods.

Of course it may be that some combination of these options may be implemented.

Whatever the advantages and disadvantage of each of these options, in practice TPLF has become the primary means of financing most class action litigation in Australia in recent years. This is notwithstanding the fact that the first major shareholder class action was conducted on a speculative basis by the law firm acting for the representative party

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23 See e.g. s 237 The Australian Consumer Law (Schedule 2, Competition and Consumer Act 2010 (Cth). Such proceedings can only be brought by the regulator on behalf of those who have consented in writing (s 242(2). See also s 149 that provides for representative actions by the regulator on behalf of persons who have suffered loss or damage as a result of defective goods.
without any arrangement in place to cover any adverse costs ordered against the representative party had the case been unsuccessful.\textsuperscript{24}

c. Advantages of TPLF in Australia

One obvious advantage of commercial litigation funding is that it has facilitated access to justice by enabling the pursuit of meritorious claims that might not otherwise have been pursued for at least two reasons.

Importantly, the fact that commercial litigation funders usually assume liability for any adverse costs order (or order for security for costs) made against a funded party removes the economic disincentive for persons to take on the mantle of representative party. Moreover, the willingness of litigation funders to finance the conduct of the litigation has facilitated the involvement of law firms that were hitherto reluctant to take on the conduct of such cases on a ‘no win no fee’ basis. Even where law firms have agreed to take on a case on a ‘no win, no pay’ basis, unlike in some Canadian cases, they have not been willing to indemnify their clients against any adverse order for costs. Commercial funding has thus increased both the supply of legal service providers and the number of individual plaintiffs willing to represent their respective classes.

Beyond these two fundamental advantages, TPLF is perceived to provide further benefits to the parties and to the justice system. Many commercial funders employ commercial lawyers with litigation experience. Cases are carefully screened and extensive due diligence investigations are usually conducted. Only those which appear to have substantial merit are funded. This serves as an important filter to prevent unmeritorious claims from being pursued.

Funders often seek out through various means, including publicity and web sites, potential class members so as to maximize the number of persons who may benefit from the funded litigation (within the constraints of the ‘opt in’ structure usually adopted in funded cases, discussed below).

Funders are understandably concerned to reduce the transaction costs of the litigation and thus usually impose budgetary constraints on lawyers engaged to act; often organise for some of the work to be undertaken by paralegals or others at lower costs than if such work was handled by the law firms at commercial charge out rates; and generally seek to exercise a degree of control over the costs of the litigation.

Funders are often proactively involved in the conduct of the litigation and in attempts to settle the proceedings. This may be beneficial insofar as they have valuable legal and commercial experience. The involvement of a large and resourceful commercial litigation funder, such as IMF, levels the litigious playing ground and in many respects serves to deter or undermine defensive forensic postures designed to tire out or exhaust individual plaintiffs.

\textsuperscript{24} King v AG Australia Holdings Ltd (formerly GIO Australia Holdings Ltd) [2003] FCA 980 (17 September 2003)
To date funders have assumed that they may only receive payment pursuant to individual contractual arrangements entered into with class members. Thus, most funded class actions in Australia have been limited to persons who have consented to the conduct of proceedings on their behalf. This has the advantage of greater certainty as to the ambit and likely value of the claims of class members. It also has obvious advantages for defendants because they are better able to estimate their potential liability and this may enhance the prospect of settlement.\(^{25}\)

Finally, funding is in the defendants’ economic interests as it ensures that any costs awards payable by the plaintiffs are satisfied.

Nevertheless, a number of the abovementioned advantages raise corresponding concerns.

d. **Adverse Consequences of TPLF in Australia**

The high threshold of merit adopted by litigation funders means that many more risky but nonetheless meritorious cases are unlikely to be funded. In addition, the high commercial return required by funders results in the rejection of smaller, albeit substantial, meritorious cases.

Funders are also disinclined to fund personal injury or product liability class actions for a variety of reasons, including the necessity, in many instances, for proof of individual causation, particularly in defective drug cases. For example, the recent Vioxx class action litigation in Australia was financed by class counsel’s firm rather than a commercial funder.\(^{26}\)

To date in Australia the financing of class action litigation by third party funders has led to what some commentators (including judges)\(^ {27}\) have contended are other undesirable consequences. Many of these ill-effects relate to ‘opt-in’ classes, which are the indirect consequence of TPLF involvement.

Because there is no certification procedure which results in an order binding the class members to the fee agreement between the representative plaintiff and class counsel or the funder, litigation funders require class members to sign litigation funding agreements entitling the funder to a share of the proceeds of the litigation if it is successful. This has resulted in the classes comprising only those who have agreed to participate (or ‘opt in’).

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\(^{26}\) The case succeeded at first instance (*Peterson v Merck Sharpe & Dohme (Aust) Pty Ltd (No 5) [2010] FCA 605 (18 June 2010)*) but was overturned on appeal(*Merck Sharp & Dohme (Australia) Pty Ltd v Peterson (No 2) [2011] FCAFC 146 (18 November 2011)*). An application for special leave to appeal has recently been refused by the High Court of Australia.

\(^{27}\) See e.g. Callinan and Heydon JJ in *Campbell’s Cash and Carry Pty Ltd v Fostif Pty Ltd (2006) 229 CLR 386* at 486-488 [*"Fostif";* Keane P, as he then was, ‘*Access to Justice and other Shibboleths*’, paper presented at the Judicial College of Australia Colloquium, Melbourne, October 2009*
The de facto creation of ‘opt in’ classes was said to be contrary to the legislative (‘opt out’) schemes adopted in the Federal Court\(^{28}\) and in the Supreme Court of Victoria.\(^{29}\) Although such challenges initially succeed at first instance, the Full Federal Court has held that it is not impermissible to have limited classes given that the legislation expressly provides that a class action may be brought on behalf of ‘some or all’ of those affected.\(^{30}\) Because ‘opt in’ classes restrict the ambit of beneficiaries to those who have agreed to enter into contractual litigation funding arrangements, access to justice by all those similarly affected has been curtailed and this undermines one of the key rationales for the class action regime. Moreover, leaving aside adverse costs issues, if you have individual instructions from all those on whose behalf proceedings are to be brought you do not need to rely upon the class action procedural mechanism at all. There are other procedural means of pursuing mass claims.

The conversion of the statutory ‘opt out’ scheme to ‘opt in’ classes has also given rise to satellite litigation and appeals designed to de-rail the proceedings in their entirety.\(^{31}\) In several instances legal challenges were brought against classes limited to persons who had entered into litigation funding agreements and/or were clients of the law firm bringing the class action proceeding. Ironically, the initial successful challenge by defendants to limited classes led to the widening of the classes in those cases. However, following further appeals, it is now clear that limited classes are permissible.

Closed classes have also led to requests for particulars of the claims of all of the individual class members.\(^{32}\) Moreover, the very issue of commercial funding of class action litigation has itself become the subject of interlocutory disputes and stay applications, whether of limited classes or opt out classes.

Although limiting classes to those who agree to participate may better enable the claims of class members to be quantified, thus potentially facilitating settlement, defendants may be disinclined to settle while the claims of other affected persons, who are not class members, are not statute barred.

\(^{28}\) Dorajay Pty Ltd v Aristocrat Leisure Ltd (2005) 147 FCR 394 (Stone J)


\(^{30}\) Multiplex Funds Management Ltd v P Dawson Nominees Pty Ltd (2007) 164 FCR 275; [2007] FCAFC 200. The decision at first instance was P Dawson Nominees Pty Ltd v Multiplex Limited [2007] FCA 1061 (Finkelstein J)


Much time, effort and expense is incurred by law firms and/or commercial litigation funders in finding and ‘signing up’ eligible persons to become group members. This increases the transaction costs of the litigation, and thus raises the rate of return charged by funders.

The perceived commercial necessity to sign up individual class members further encourages competition amongst law firms and has led to multiple class actions being filed in a number of instances. These may be multiple limited ‘opt in’ classes and/or ‘opt out’ classes that exclude those already encompassed by ‘opt in’ proceedings.

The settlement or resolution of the limited class action does not prevent, and indeed may encourage, follow on proceedings by those who did not agree to participate in the original ‘opt in’ class action(s). This is counter to the judicial efficiency rationale of the class action regime. It is also contrary to the interests of respondents to be subject to a multiplicity of proceedings arising out of the same, similar or related circumstances.

There are other adverse consequences unrelated to closed classes. In view of the potentially large outlays and risks, third party litigation funders require those assisted to agree to a relatively substantial proportion of their recovery being paid to the litigation funder in the event of success. Thus, the overall net recovery received by individual class members is correspondingly reduced. According to the empirical research by Morabito, in the eleven Part IVA cases encompassed by his research that had settled at the time of writing, 30.67% of the settlement amounts were paid to the litigation funders.33

In funded cases which are successful, either by way of judgment or settlement, the legal costs recovered from the unsuccessful defendant will not necessarily recoup all of the legal costs incurred on behalf of the class during the conduct of the proceedings. In many cases, the legal fees and expenses incurred by the representative plaintiff exceed AU$10 million. Because lawyers are prohibited from charging fees as a percentage of the amount recovered, the transaction costs incurred in conducting funded class actions include both the legal fees and expenses and the commercial return to the litigation funder. As both lawyers and funders seek to make a profit from their respective contributions the overall transaction costs are increased and the net return to the class members is correspondingly decreased.

The active involvement of commercial litigation funders in the conduct of proceedings, including settlement discussions and decision-making, may complicate or exacerbate ethical and conflict of interest problems. Some of these difficulties are adverted to by the various members of the High Court, particularly those in dissent, in the Fostif

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33 Morabito V and Waye V, ‘Reigning in Litigation Entrepreneurs: A New Zealand Proposal’ [2011] New Zealand Law Review 323 at 346. As noted by Morabito and Waye, there have been proposals for the capping of the amounts payable to litigation funders. One large commercial law firm acting on behalf of a tobacco company has proposed that returns should be capped at 25% of any damages award: Allens Arthur Robinson ‘Access to Justice Submission on behalf of Philip Morris Limited’ (2009) referred to at note 114 on p 349.
Also, the involvement of funders in the management and conduct of litigation may often cause tension in the relationship with the law firm conducting the litigation.

Some have contended that the introduction of litigation funding, and the perceived unholy alliance between ‘entrepreneurial’ law firms and commercial funders motivated by profit, has led to undesirable ‘trafficking’ in litigation whereby cases (albeit meritorious) are orchestrated by lawyers and funders rather than initiated or driven by clients or class members.

Finally, some have expressed concern at the potential for abusive or unmeritorious class actions being commenced and being improperly used to coerce settlements so as to avoid the prohibitive costs of defending the proceedings. There is little empirical evidence of this occurring and in practice, the ‘loser pays’ costs rule serves as a powerful disincentive to unmeritorious claims. Nevertheless, the facts of the Fostif litigation gave rise to an understandable expression of judicial concern amongst some members of the High Court. Justices Callinan and Heydon raised concerns about, inter alia, the aggressive marketing campaign to solicit class members, the fact that many of the claimants had not previously made claims and would not have done so but for the approaches made to them; the use of discovery motions to identify potential further claimants; the authority sought from claimants to authorize the funders (an accounting firm) to control the conduct of the litigation, enter into settlement negotiations and receive monies; the limited role of the solicitor conducting the proceedings; the ‘entrepreneurial’ nature of the litigation; and the fact that the funder was not subject to the same ethical and fiduciary duties as lawyers.

In the view of Justices Callinan and Heydon (in dissent) an ‘abuse of process’ arose out of a combination of factors: the profiteering motive of the funder; the encouragement of persons to sue who would not otherwise have done so; the small size of the individual claims which in any event amounted to a ‘windfall’; the large profit likely to have been made by the funder; the funder’s control of the litigation; the subservience of the claimants’ interest to those of the funder; the limited role of the plaintiffs’ solicitor; and the monopoly position of the funder. A number of similar concerns have driven various proposals for regulation of the TPLF industry in Australia. These are referred to below.

One obvious concern of respondents who successfully defend proceedings is whether they are able to recover any costs out of the pockets of commercial litigation funders. To

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34 Fostif (n 27).

35 (Former) High Court Justice Callinan was less than complimentary about the ‘increasingly competitive entrepreneurial activities of lawyers undertaking the conduct of class actions or group actions’ in Mobil Oil Pty Ltd v Victoria (2002) 211 CLR 1, 73 [172] which was further quoted in Fostif (n 27) 486-488, in the joint judgment of Callinan and HeydonJJ.

36 Fostif (n 27); Keane P, as he then was, ‘Access to Justice and other Shibboleths’, paper presented at the Judicial College of Australia Colloquium, Melbourne, October 2009.

37 Fostif (n 27).
date, a number of cases have highlighted both legal and financial constraints on recovery from (some) litigation funders and led to a call for enhanced solvency requirements. These and other issues in relation to regulation are referred to below.

Most commentators in Australia concur that TPLF gives rise to the advantages that we have described. There is greater debate surrounding its adverse consequence. Some of the disadvantages are clear cut (e.g. the limited class problem) whilst others are more theoretical than real. One of the alleged disadvantages (eg. fostering unmeritorious claims) is at odds with the fact that commercial litigation funders set a high threshold of legal merit and assume the risk of an adverse costs order which serves as a powerful disincentive to taking on unmeritorious cases. Moreover, the financial and other data set out above on the performance of IMF in Australia over the past ten years shows that losses and pay outs on unsuccessful cases have been modest whereas recoveries in successful cases have been substantial. However, as the Australian experience demonstrates, the advantages and disadvantages of commercial funding need to be considered with reference to the specific facts of particular cases and the nature of the funding arrangements, rather than in the abstract. But even on the facts of particular cases, as the Fostif decision of the Australian High Court demonstrates, there is much scope for differences of viewpoint.

e. Legal Challenges Based on Funding Arrangements

As noted above, in Australia there have been numerous legal challenges to class actions and other civil actions based on commercial funding arrangements, a number of

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38 Decisions of the Full Federal Court in which issues relating to litigation funding generally have arisen include for example: HPM Pty Ltd v Fear [2002] FCAFC 403 (9 December 2002) (an appeal from a decision to strike out proceedings); Bennell v State of Western Australia [2004] FCAFC 338 (23 December 2004) (where an issue about Commonwealth Government funding for native title claims arose); IMF (Australia) Ltd v Sons of Gwalia Ltd (Administrator Appointed) [2005] FCAFC 75 (12 May 2005) (whether a commercial funder could access information in a share register to contact shareholders); Deloitte Touche Tohmatsu v JP Morgan Portfolio Services Limited [2007] FCAFC 52 (16 April 2007) (whether an agreement giving control of litigation to a non party constitutes an abuse of process); Multiplex Funds Management Limited v P Dawson Nominees Pty Limited [2007] FCAFC 200 (21 December 2007) (whether a limited class, confined to persons who had entered into a litigation funding agreement was inconsistent with the class action statutory provisions); Welsh v Digilin Pty Ltd [2008] FCAFC 149 (19 August 2008) (appeal from dismissal of proceedings where the impecunious appellant had purportedly sought litigation funding); IMF (Australia) Limited v Meadow Springs Fairway Resort Limited (in Liquidation) [2009] FCAFC 9 (6 February 2009) (dispute as to priority between funds payable to a litigation funder and the moneys owed to secured creditors of a company in liquidation); IMF (Australia) Ltd v Meadow Springs Fairway Resort Ltd (In Liquidation) (No 2) [2009] FCAFC 69 (4 June 2009) (dispute as to the priority to be given to the amounts payable to the litigation funder and the basis of calculation of costs); Fowler v Lindholm, in the matter of Opes Prime Stockbroking Limited [2009] FCAFC 125 (4 September 2009) (dispute as to how payments to litigation funder were to be dealt with in schemes of arrangement); Brookfield Multiplex Limited v International Litigation Funding Partners Pte Ltd (includes corrigendum dated 4 November 2009) [2009] FCAFC 147 (20 October 2009) (whether a litigation funding arrangement in a funded class action constitutes a managed investment scheme, within the meaning of the Corporations Act 2001 (Cth)); Brookfield Multiplex Limited (ACN 008 687 063) v International Litigation Funding Partners Pte Ltd (No 2) [2009] FCAFC 182 (22 December 2009) (appropriate orders to be made following the finding that the litigation funding arrangement constituted a managed investment scheme); Fortress Credit Corporation (Australia) II Pty Ltd v Fletcher [2011] FCAFC 89 (25 July 2011) (litigation funding arrangements considered in the context of winding up proceedings).
which have resulted in appeals. The most significant challenges have related to maintenance, champerty and abuse of process; the characterization of TPLF agreements as financial products; the question of whether TPLF arrangements amount to managed investment schemes; and the restriction of classes to persons who have entered litigation funding arrangements.

Early on and in a number of cases, TPLF was challenged on the basis that it gave rise to an abuse of process or was contrary to restrictions on maintenance and champerty. The High Court largely resolved these questions in Fostif\(^{40}\) when it ruled that the commercial funding of litigation in return for a share of the proceeds is not, \textit{per se}, an abuse of process or contrary to public policy.

The initially successful challenges to closed classes (limited to those who had entered into litigation funding agreements) was judicially resolved (subject to any further consideration of the matter by the High Court) by a decision of the Full Federal Court that the class may be limited to ‘some’ of those affected (in accordance with the express provision of the class action statute). The recently introduced NSW class action laws make it clear that it is not inappropriate for the class to be limited to those who have aggregated together for a particular purpose such as a litigation funding arrangement.\(^{41}\)

The challenge to funded classes on the basis that they amounted to management investment schemes failed at first instance but succeeded (by majority) on appeal. However, this was a pyric victory because, as noted in section (f) i. below, the federal regulatory body has provided interim exemptions from compliance with the statutory requirements.

In 2010 defendants successfully argued that a litigation funding agreement constitutes a ‘financial product’ within the meaning of Chapter 7 of the \textit{Corporations Act 2001} (Cth), requiring the funder to hold an Australian financial services license unless exempted.\(^{42}\) In that case, the funder did not hold such a license. Other funders, such as IMF (Australia) Ltd, do hold financial services licenses. Although the federal regulatory body has granted exemptions from this requirement, on 28 October 2011 the High Court granted special leave to appeal from the decision of the NSW Court of Appeal. As of the time of writing, the appeal had not been determined.

A test case has yet to be brought to determine whether a funder may obtain court approval for the payment of a fee out of the proceeds of the recovery in an ‘opt out’ class action in the absence of contractual agreements with class members. An argument can be


\(^{40}\) \textit{Fostif} (n 27).

\(^{41}\) Section 166(2) Civil Procedure Act 2005 (NSW).

put that individual contracts with class members are not required in order for the class to be bound by a court order approving a funding arrangement. Arguably, based in part on Canadian precedent,43 Australian statutory and/or equitable principles may in fact permit a court in a class action to make orders for the payment of a percentage of the recovery by an opt out class to a litigation funder that has financed the litigation. Should the Australian courts agree, access to justice would be improved; the reduced transaction costs coupled with the court’s supervisory role would result in a greater per capita recovery to class members, ensure reasonable funder fees, 44 and avoid the controversial issue of closed classes.

f. Regulation of Funded Class Actions

It is typically argued that there are four areas of concern that call for some form of regulatory intervention:

1. The size of the return to the funder;
2. The potential for the funder to control the conduct of the proceedings;
3. The financial capacity of the funder, particularly its ability to meet any adverse costs order; and
4. Conflicts between the funder, the class members and the lawyer(s) representing the class.45

Each of these areas could be the subject of judicial supervision and control, arguably without the need for any other form of regulation (as is the case in class actions in the United States and Canada), if litigation funding arrangements are within the ambit of judicial power in the class action context. In certain contexts they clearly are (e.g. where it is alleged that they give rise to an abuse of process, etc). To date in Australia, however, the

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43 See discussion in Part III.a. below.

44 In approving of the settlement in a recent class action Flick J observed: “Short of refusing approval to a settlement, it may be that the power of the Court conferred by s 33ZF(1) to ‘make any order the Court thinks appropriate or necessary to ensure that justice is done in the proceeding’ confers a power to grant approval – but subject to a condition limiting the amount payable to the litigation funder. Obviously enough, even if the power could be so exercised, it should not be done without hearing submissions and perhaps evidence from the funder concerned. That evidence may address both the risks of providing funding in the proceeding presently before the Court and the risks incurred more generally in providing funding in other proceedings. Such a conditional order would not itself operate as any variation of the contractual agreement reached between the funder and each group member. But such reservations need not be further pursued. The percentage of the settlement monies to be paid to the litigation funder in the present proceeding is accepted to be below that paid in other proceedings and the overwhelming number of group members has expressed no objection to the amount.” Pharm-a-Care Laboratories Pty Ltd v Commonwealth of Australia (No 6) [2011] FCA 277 (25 March 2011) [42-43]

reigning paradigm has been that third party funding arrangements are a matter of private contract, except where they may give rise to an abuse of process such as to justify judicial intervention in the funded proceedings. Various proposals for statutory or regulatory oversight have not been implemented and, as noted in subsection i. below, funders have been given interim exemption from those statutory requirements that have been judicially determined to be applicable.

i. Regulation as ‘Managed Investment Schemes’ or ‘Financial Products’

In Brookfield Multiplex Limited v International Litigation Funding Partners Pte Ltd46 the Full Federal Court held (by majority) that funded class actions are managed investment schemes as defined in the Corporations Act 2001. This meant that litigation funding arrangements were subject to a wide range of registration, licensing, conduct, disclosure and other requirements on litigation funders and their arrangements with their clients.

The Federal Government resolved to act to reverse the effect of the Federal Court. Since the Multiplex decision in 2009, litigation funding arrangements have remained governed by class orders issued by the Australian Securities and Investment Commission (ASIC) which exempt them from the Corporations Act.47 In mid-2011, the Federal Government issued draft regulations48 that impose a requirement that all litigation funders have adequate policies and procedures in place to manage any conflicts of interest. The regulations do not require funders to be licensed.

As referred to in part (e) above, a further complication arose with the decision of the NSW Court of Appeal that litigation funding arrangements constitute ‘financial products’ such that they could be rescinded unless the funder held an Australian financial services license.49 Accordingly, regulations have been proposed that would also exempt litigation funding schemes from the definition of a ‘managed investment scheme’ in the Act. In order to clarify that these arrangements are also not ‘financial products’ as defined in Chapter 7 of the Act, the proposed Regulations would provide exemptions from the licensing, conduct and disclosure requirements in the legislation. However, in view of concerns about potential conflicts between the interests of litigation funders compared to those of their clients in certain situations, for example when assessing proposed awards or settlements, the Australian Government has resolved that these concerns would be addressed by making the exemptions conditional on appropriate arrangements being put in place to manage conflicts of interest.


47 Class order 10/333 of 5 May 2010. This was intended to be in force only until 30 September 2010 but has been extended.

48 Draft Corporations Amendment Regulations 2012

49 International Litigation Partners Pte Ltd v Chameleon Mining NL (2011) 276 ALR 138; [2011] NSWCA 50. The case is currently on appeal to the High Court.
In 2010, the Government approved draft regulations carving out funded class actions, as well as similar arrangements, from the definition of managed investment scheme in the *Corporations Act*. The Assistant Treasurer and Minister for Financial Services and Superannuation has released for public consultation an exposure draft of related regulations to clarify that funded class actions, as well as similar arrangements, are not managed investment schemes under section 9 of the *Corporations Act* 2001.

Funded litigation and class actions continue to be regulated under a range of other legislation of general application. For example, funders are subject to the general consumer protection provisions in the *Competition and Consumer Act 2010* and the *Australian Securities and Investments Commission Act 2001* (in matters such as unconscionable or misleading conduct). Also, legislation governing the conduct of class actions arguably confers power upon judges to deal with litigation funding arrangements in such cases. Moreover, in the case of conduct amounting to abuse of process there is no question that courts have power to intervene.

### ii. Uniform Judicial Regulation

As Morabito and Waye have noted, judges acting under the auspices of the Council of Chief Justices of Australia and New Zealand considered a proposal to harmonise rules of court relating to litigation funding in order to expressly empower courts to order the payment of costs and security for costs by litigation funders. This proposal has not been pursued. However, in most if not all Australian jurisdictions, courts presently have power to order costs against litigation funders and to require that security for costs be provided by funded parties.

Recently adopted Practice Notes in the Federal Court and the Victorian Supreme Court require disclosure of funding agreements by which a litigation funder is to pay or contribute to any costs of the proceedings, though not necessarily all of the terms thereof. There may be some tension between these disclosure requirements and the existing Australian law on privilege. In a number of cases Australian courts have grappled with whether litigation funding agreements or information are required to be disclosed to non-funded parties to the litigation or are protected by privilege or should otherwise remain confidential. In a number of instances, confidentiality orders have been sought in cases where liquidators have obtained court approval of litigation funding arrangements.

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50 Morabito and Waye (n 33) at 354

51 According to the Practice Note, “[a]ny funding agreement disclosed may be redacted to conceal information which might reasonably be expected to confer a tactical advantage on the other party”: Practice Note CM 17 - *Representative Proceedings Commenced under Part IVA of the Federal Court of Australia Act 1976*; in the Supreme Court of Victoria: see Practice Note No 9 of 2010 *Conduct of Group Proceedings*.

52 See e.g. Re Global Medical Imaging Management Ltd [2001] NSWSC 481; Apple Computer Australia Pty Ltd v Wily [2002] NSWSC 855; Spatialinfo Pty Ltd v Telstra Corporation Ltd [2005] FCA 455; Re Kingsheath Club [2003] FCA 1034 discussed in Cashman P, *Class Action Law and Practice*, The Federation Press, 2007 at 184-186. See also the more recent decisions in: Lion Energy Limited v Tulloch Lodge Limited (in liq), in the matter of Tulloch Lodge Limited (in liq) [2011] FCA 1139; Fletcher and Barnet, in the matter of Octaviar Limited...
iii. Uniform Regulation by Government

The Standing Committee of Attorneys General has given consideration to regulation of litigation funders and published a discussion paper in 2006. However, the issue was subsequently remitted to the Federal Government for further consideration. The Federal Government’s present position is summarised in subsection i. above.

iv. Regulation as Legal Services

In March 2012, the NSW Legal Services Commissioner published a paper calling for a new model of regulation of TPLF; he argued that litigation funding is more closely aligned to the practice of law and should thus be classified as a legal service, with the funder having a primary duty to the court.

In summary, the regulation of litigation funders remains a vexed issue in Australia and various alternatives have been advocated. As a result of listing on the stock exchange and by virtue of holding a financial services license, Australia’s largest litigation funder, IMF, is already subject to numerous regulatory requirements. It remains to be seen whether the proposed introduction of procedures for dealing with conflicts of interest will have any significant impact on litigation funders generally. However, many of the corporate expressions of concern focus on solvency requirements and the financial capacity of funders to meet any adverse order for costs against the funded party (or the funder). To some extent, existing mechanisms for obtaining orders for security for costs may provide adequate protection. Also, as noted above, various forms of unconscionable or misleading conduct are already the subject of legislative prohibitions and remedial provisions. In the absence of evidence of the funding of unmeritorious claims and/or conduct amounting to an abuse of process the perceived problems may be more illusory than real. What is of understandable concern to corporate and other defendants is that commercial funding has facilitated the pursuit of claims that would otherwise not have been instituted and resulted in substantial recoveries, particularly in shareholder class actions.

III. Canada

Commercial litigation lending arrived in Canada approximately ten years ago, and targeted individual plaintiffs, usually in personal injury litigation, but also wrongful


53 Litigation Funding in Australia, May 2006.

dismissal, breach of contract and other civil disputes. Such lending rarely attracted the attention of either the courts or the regulators of the legal profession.

Much more recently, funders have turned their attention to large commercial lawsuits and class actions. Accompanying this shift has been a marked increase in public scrutiny and controversy. This may be so for three reasons. First, class actions involve a much greater degree of judicial oversight than ordinary actions, and it is inevitable, therefore, that commercial funding of class actions would necessitate some judicial consideration. Second, the advent of TPLF in class actions puts into stark relief the entrepreneurial nature of class action litigation, a feature with which judges and others continue to be uncomfortable. Third, as in Australia, the presence of a litigation funding arrangement may provide a basis for collateral attack by defendants on the litigation itself.

a. Origins of Litigation Funding

In the early 2000s, commercial funding of litigation was limited to non-recourse loans to individual plaintiffs, with interest rates of 35% or higher. Funders are neither insurers nor financial services institutions for the purposes of regulatory oversight in those industries. These lenders of last resort charge administration charges and other fees that bring the cost of borrowing close to the 60% annual interest rate prohibited by the Criminal Code. Such lending is viewed by some as inherently predatory. In a recent personal injury action, an Ontario judge described the loan obtained by the plaintiff from a large lender, LexFund, as “unconscionable” and “usurious”. In response to the plaintiff’s lawyer’s argument that the lender had secured the plaintiff’s access to justice, the judge retorted: “This loan agreement does not facilitate access to justice. This loan agreement does nothing to advance the cause of justice. It is difficult to believe that any lawyer would refer a vulnerable client to such a lender.”

Nevertheless, TPLF of personal injury claims remains the only alternative for plaintiffs who otherwise cannot afford to pay their lawyers and everyday living expenses. Because


56 Litigation funding made on a non-recourse basis does not appear to fall within the definition of “insurance”: Insurance Act, R.S.O. 2000, c.I-3, s. 1. It is less clear why such financing does not fall within the ambit of either banking or securities regulation. According to Puri, there are strong doctrinal and public policy arguments that TPLF is subject to securities laws, unless it fits within one of the prospectus exemptions: Poonam Puri, “Financing of Litigation by Third-Party Investors: A Share of Justice?” (1998) 36 Osgoode Hall LJ 515 at 543.

57 “The Loan Arrangers,” (n 55).

58 Giulian v. Region of Halton, 2011 ONSC 5119. In this case, the fees and disbursements charged by the plaintiff’s lawyer coupled with the interest rates and other fees charged by LexFund dwarfed the $375,000 in damages awarded to the plaintiff. The judge refused to include LexFund’s exorbitant fees in his cost order.

59 Ibid. at para 56.
Canadian provinces operate on the two-way cost rule in most types of litigation, the risk of adverse costs creates further barriers to the court system for low and middle-income Canadians, barriers that a few funders are willing to assist in overcoming by offering indemnities to plaintiffs against adverse cost awards.

Unlike the U.S., and as is the case in Australia, TPLF in Canadian class actions is publicly known and judicially approved. With only two known exceptions in the mid-1990s involving syndicates of investors, TPLF of class actions did not occur – publicly – until 2009. It was in this year that an Alberta court made an *ex parte* order approving an indemnity and funding agreement between the representative plaintiffs and BridgePoint Financial. A year later, a Nova Scotia court followed suit, with the same funder.

In Ontario, however, a motion to approve a funding and indemnification agreement between the representative plaintiff and Claims Funding International Inc. (CFI) was brought on notice to the defendant in 2009 and suffered a different fate. In *Metzler Investment*, Leitch J. concluded that a funding agreement will be champertous if it is "spurred by some improper motive" and that the nature and amount of the fees to be paid are critical in determining whether the motivation was improper. She concluded that in the case before her it was too early to conclude that the agreement was reasonable since there was no cap on the ultimate amount to be paid to the funder. The agreement in question provided that CFI would recover 7% of any “resolution amount”, the amount for which the plaintiff’s claim is settled or for which judgment is given in favour of the plaintiff, less legal fees and disbursements and administration expenses. CFI’s fee, therefore, bore no relationship to the amount of money paid by CFI, the period of time during which those monies were outstanding, the degree of risk assumed by CFI or the extent of its exposure to costs. An arrangement that potentially over-compensated the funder could not be said to

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61 In one action, Nantais v Telectronics, the syndicate loaned a representative plaintiff $350,000 for disbursements. The court approved the arrangement without issuing public reasons. In the second action, Smith v. Canadian Tire Acceptance Ltd., 1995 CanLII 7163 (ON SC), Winkler J (as he then was), found that the arrangement constituted champerty and maintenance, and ordered the syndicate and its mastermind to pay the adverse costs of the failed summary judgment motion to the defendants.

62 Hobshawn v Atco Gas and Pipelines Ltd. (May 14, 2009), Action 0101-04999 (Alta. Q.B.) [unreported].

63 MacQueen v Sydney Steel Corporation (October 19, 2010), Action 218010 (N.S.S.C.) [unreported]. Note that in Hobshawn, the funding entity was BridgePoint Financial Services Partnership III. In the Nova Scotia case, a new partnership was formed called BridgePoint Financial Services Partnership IV. It is not known how many of the partners in each funding arrangement overlapped.


65 Ibid para 12.

66 Ibid para 71.
be reasonable, and unreasonable compensation evidenced 'improper motive', one of the hallmarks of a champertous arrangement. Ultimately, the judge did not approve the funding agreement.67

Metzler’s lawyers took up the issue anew before a different judge in Dugal v. Manulife.68 There, Strathy J. first had to address the jurisdictional question of whether he had the authority, prior to the action being certified as a class proceeding, to approve a funding agreement that would eventually bind the class. He accepted that the funding arrangement potentially affected the litigation process and the due administration of justice, and impacted the defendants and the putative class members. On these bases, he interpreted s. 12 of the Class Proceedings Act,69 which gives the court broad jurisdiction to “make any order it considers appropriate respecting the conduct of a class proceeding to ensure its fair and expeditious determination”, as authorizing him to consider the funding agreement in the early stages of the litigation.70 In effect, the judge is entitled to put himself in the shoes of the class members and consider whether the funding agreement is fair. Court approval of the funding agreement thus obviates the need to contract with each individual class member, as has been the practice in Australia. The case management judge acts as a proxy for the entire class, and once the agreement is approved, it binds both the representative plaintiff who has contracted with the funder, and the putative class members who are strangers to that contract.

Having established his jurisdiction to consider the agreement, Strathy J. then focused on the substantive issues. The defendant argued that TPLF was contrary to public policy and offended the law of champerty and maintenance, laws whose fundamental purpose was to “protect the administration of justice from abuse by the exploitation of vulnerable litigants.”71 Strathy J. remarked that TPLF was judicially approved in England and Australia but noted that the situation in Australia was “different” because contingency fees are not statutorily permitted there.72 No other differences between the three jurisdictions’ procedural or legal architecture were cited. After referring to the existence of the Class Proceedings Fund73 and the practice of many plaintiff’s counsel to provide indemnities

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67 Leave to appeal Justice Leitch’s decision was granted on the basis that there was good reason to doubt the correctness of her conclusion that TPLF agreements were not champertous per se: Metzler Investment GMBH v Gildan Activewear Inc (March 9 2010), London 58574CP (Sup. Ct. J.) [unreported]. The case ultimately settled before the appeal could be heard: 2011 ONSC 1146 (CanLii).

68 2011 ONSC 1785.

69 S.O. 1992, c. 6 (CPA).

70 Dugal (n 7) para 16.

71 Dugal (n 7) para 18.

72 Dugal (n 7) paras 24-25.
against adverse costs awards to the representative plaintiffs, Strathy J. concluded that TPLF does not undermine the objective of champerty laws to “protect the administration of justice.” Quite the opposite, he found that such funding improves access to justice for plaintiffs and is therefore beneficial to the administration of justice.74

Strathy J. clearly derived comfort from a number of factors that distinguished the case before him from Metzler. First, while the funding agreement in Dugal provides for the same 7% fee CFI was to charge in Metzler, there was also a cap of $5 million if the case settled pre-trial, and $10 million thereafter.75 Second, Leitch J. had cautioned that while the court had broad discretion under s. 12 of the CPA, it was inappropriate to exercise that discretion when the action had not yet been certified and class members had not had an opportunity to present their views.76 In Dugal, counsel gave notice of the agreement to a “representative” (but undefined) cross-section of class members, who approved of its terms. Third, the agreement in Metzler provided that CFI could terminate the contract without cause on seven days’ notice. Leitch J. held that such power in CFI’s hands could influence decision-making within the litigation to fulfill its own interests and agendas, and thereby amounted to officious intermeddling.77 In Dugal, there was an express provision that the power to instruct counsel rested solely with the representative plaintiff; the funder was entitled only to “appropriate information about the progress of the litigation.”78 In the result, after requiring the posting of security by the Ireland-based funder, Strathy J. approved the funding agreement.

As of the time of writing, two other funding agreements have been submitted for court approval, with hearings scheduled in late spring 2012. In the words of one counsel interviewed for this paper, “we are just getting to the start line” for TPLF in Canadian class actions.79


Since only one funding agreement in a class action has received public court approval to date, little information is available about the ways in which the agreements are structured. For this reason, interviews of class counsel were conducted in March 2012 to

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73 The Fund was created by regulation in 1992 with seed money of $500,000. The Fund now has over $10 million that it distributes to successful applicants for disbursements. Importantly, the Fund also indemnifies the representative plaintiffs in funded actions against all adverse cost awards. See the Law Foundation of Ontario website, online http://www.lawfoundation.on.ca/cpcabout.php.

74 Dugal (n 7) para 33.

75 Dugal (n 7) para 33.

76 Metzler (n 64).

77 Metzler (n 64) para 60.

78 Dugal (n 7) para 33(c).

79 Interview with respondent 7 (9 March 2012).
determine whether they are using or planning to use commercial litigation funding, the nature and terms of such agreements, and the role of the funder.\textsuperscript{80} Nine leading class action lawyers were contacted, eight of whom participated in telephone interviews. Five of the eight respondents had entered into, or were in the process of negotiating, third party funding agreements. Two of the other respondents were not interested in such financing; one respondent indicated that the terms on which a funder had been willing to finance a class action were too onerous;\textsuperscript{81} the other respondent had never negotiated with a funder but said that s/he would not do so because “offloading the risk meant a reduction in counsel fees.”\textsuperscript{82} The eighth respondent had obtained a non-recourse loan for a class action in the past, but was unlikely to do so again, preferring to self-finance in certain cases, and to go to Ontario's Class Proceedings Fund in the more risky ones.\textsuperscript{83}

The funding agreements currently under negotiation or already approved are principally indemnity agreements, with modest or no monies advanced by the funder. This is in stark contrast to the typical funding arrangement in Australia where significant financing is advanced to class counsel for both disbursements and (often) fees. The difference in the two regimes is readily understandable. Australian class counsel, prohibited from acting on a true contingency fee basis, do not have the war chest that Canadian class counsel have amassed as a result of successful litigation generating multiples of their usual hourly rates. All counsel interviewed for this paper agreed that the risk of adverse costs in two-way costs regimes (like Ontario and Alberta) is the primary impetus for seeking TPLF arrangements. The alternatives – provision of an indemnity by the representative plaintiff's counsel or by the Class Proceedings Fund in approved cases – are increasingly unattractive for a number of the respondents. In terms of the personal indemnity provided by class counsel’s firm, the risk of paying adverse costs to the defendants, particularly in light of recent decisions awarding hundreds of thousands of dollars against the representative plaintiff, is simply too great.\textsuperscript{84} The Class Proceedings Fund’s 10% levy,\textsuperscript{85} with no cap or flexibility as a result of governing regulation, is seen by some to be too high.

The funding agreements approved to date are contracts between the funder and the representative plaintiff. One respondent stated candidly that the contract is “primarily with

\textsuperscript{80} In accordance with the clearance obtained from the Research Ethics Board of the University of Windsor, the data collected from counsel will be reported on a not for attribution basis.

\textsuperscript{81} Interview with respondent 2 (6 March 2012).

\textsuperscript{82} Interview with respondent 3 (6 March 2012).

\textsuperscript{83} Interview with respondent 8 (30 March 2012).

\textsuperscript{84} Costs were awarded to the defendant in Kerr v. Danier Leather, 2007 SCC 44 for the trial, Court of Appeal and Supreme Court of Canada levels. The total costs were estimated to be over $1 million. More recently, plaintiffs who lost certification motions were ordered to pay $525,000 and $200,000 in Fresco v. CIBC, 2010 ONSC 1036 [appeal argued in early 2012] and Williams v. Canon Canada Inc., 2012 ONSC 1856, respectively.

\textsuperscript{85} Class Proceedings, O Reg 771/92, sections 8(3) and 10.
class counsel but technically with the representative plaintiff”.

Other respondents were adamant that the funder must formally contract with the representative plaintiff, because the indemnity benefits only the plaintiff. Even where the funding agreement contemplates modest or substantial advances of funds for disbursements, however, counsel maintain that the agreement is properly between the funder and the representative plaintiff, not class counsel. This contractual structure differs from the common practice in Australia, where funders routinely contract with class counsel for the funding of legal fees.

Unlike litigation financing of some personal injury litigation, the funding of class actions is not structured as a loan but rather as an investment with a return calculated as a percentage of the settlement or judgment if one is obtained. To date, the return has been less than the Class Proceeding Fund’s 10% levy, but two respondents were quick to point out that a financing agreement that contemplates a significant advance of funds for disbursements or fees would necessarily require a higher levy. Other respondents opined that the market benchmark set by the Class Proceedings Fund would necessarily limit commercial funders’ levy to less than 10%, even in provinces outside of Ontario. Given the nascent industry in Canada, it is difficult to predict whether rates of return will approach those routinely earned by Australian funders.

Unlike Australian litigation funders which play a significant strategic and advisory role in the class actions they fund, Canadian funders do not appear to have strategic control of their cases. In both Metzler and Dugal, it was extremely important to the judges that the agreements stipulated that the representative plaintiff had the sole authority to instruct counsel. When asked about the involvement of the funder in settlement negotiations, all lawyers interviewed for this paper stated that there was no role for the funder. “Plaintiff’s counsel’s obligation is to the client; counsel needs to know the funder well and have confidence in them. We don’t want a pushy funder.”

The sense obtained from the majority of the respondents is that the funder makes the decision whether to finance a lawsuit predominantly based on the identity of plaintiff’s counsel. Confidence in counsel also explains funders’ willingness to have no control in the

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86 Interview with respondent 7 (n 79).

87 Interviews with respondent 5 (7 March 2012) and respondent 4 (6 March 2012).

88 Interview with respondent 6 (7 March 2012).

89 Interviews with respondent 6 (n 88) and respondent 7 (n 79).

90 Interviews with respondent 5 (n 87) and 4 (6 March 2012).

91 According to respondent 6 (n 88), the funder plays a “zero” role. Respondent 7 said that the funder “can’t call the shots” while respondent 2 stated that s/he “would not want to be beholden to the funder” in terms of the direction of the lawsuit.

92 Interview with respondent 5 (n 87).
Due diligence conducted by the funders involves a detailed interview of class counsel, as well as a review of the pleadings and key documents, in order to evaluate the strengths in the case. This is not unlike the process engaged in by the Class Proceedings Committee in Ontario, though the latter is also concerned with the public interest elements of the action, a matter with which commercial funders are not concerned.94

### c. Ethical Concerns

As a result of Strathy J.’s decision in *Dugal*, and unless a higher court disagrees with his interpretation of the relevant statutes, it appears that maintenance and champerty laws, which remain in force in all of Canada, will not bar commercial litigation funding of class actions.95 The three principal mischiefs which champerty rules aim to cure are the promotion of unnecessary litigation by a non-party; intermeddling in the conduct of the litigation; and, the over-compensation of the funder. Judicial oversight of TPLF in class actions goes some distance toward ensuring that these three evils are avoided.

#### i. Promotion of Unnecessary Litigation

In the context of champerty cases, courts have long scorned the ‘stirring up’ of litigation.96 In one of the earliest class actions, Winkler J. (as he then was) voiced similar disapproval of an investment scheme in which the funder created a syndicate of investors and then retained counsel and identified the cause of action.97 In that case, Winkler J held that the *Class Proceedings Act*:

> does not envisage that causes of action, legitimate though they may be, will be identified and class members recruited, for the ultimate financial gain of the organizers. Instead, the legislation anticipates a genuine representative plaintiff. The purpose of the legislation is to facilitate the litigation of causes of action and not to generate them for financial gain.98

It is not clear, however, how long courts can maintain a principled rejection of funder-initiated litigation. The classic paradigm of client-initiated lawsuits does not reign in class

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93 Ibid.

94 Interview with respondent 4 (n 87). Under section 5 of Ontario Regulation 771/92 (n 85), the Class Proceedings Committee makes a determination whether to fund a class action on the basis of three primary considerations: the extent to which the issues in the proceeding affect the public interest; the likelihood that the action will be certified; and the financial status of the Fund.

95 For a thorough analysis of champerty and maintenance laws in the context of commercial litigation funding of individual litigation, see Puri (n 56).

96 Newswander v. Giegerich (1907), 39 SCR 354 at 360.

97 Smith v Canadian Tire Acceptance Ltd (n 61).

98 Smith v Canadian Tire Acceptance Ltd (n 61) para 72.
actions. It is now accepted that, in the name of access to justice, class counsel may identify causes of action and recruit representative plaintiffs. It is foreseeable, therefore, that the same principles will be used to support the argument that a funder-identified lawsuit, brought to class counsel with whom a working relationship has been forged, equally promotes justice for wronged, albeit unaware class members, and ought to be approved.

**ii. Control of the Claim**

Class action judges have repeatedly stressed that class representatives must be genuine and active, not mere pawns of class counsel. On this basis, courts have held that they are entitled to know whether some other party is funding the litigation and, if so, who is doing so and on what terms. The answers go to the independence and motivations of the representative plaintiff as well as the ability of the representative plaintiff to see the action through to completion. [...] In the context of third party funding arrangements, the Court has been particularly concerned to know the details of the arrangements with the third party to ensure that the representative plaintiff, and not the third party, is actually calling the shots.

Concerns regarding officious intermeddling are at least partly addressed by express provisions in the funding agreement that restrict the role of the funder in the conduct of the litigation to that of an interested but experienced observer who is entitled to be kept apprised of important developments in the case, but who is not permitted to withdraw from the funding arrangement unless plaintiff’s counsel fails to prosecute the attention entirely or the representative plaintiff changes counsel. John Rossos, the principal of BridgePoint (the funder in the Alberta and Nova Scotia class actions referred to earlier), has observed that funders trust the expertise of class counsel and are therefore happy to act as passive investors. Yet in the same article, Rossos argues that third party funders’ “specialized knowledge or relevant expertise may add significant value to class counsel by assisting in the development of a litigation strategy or plan, the recruitment of experts, the compilation of evidence, and the evaluation of the terms of any settlement.” Even if not rising to the level of “officious intermeddling” for the purpose of maintenance laws, the involvement of another significant stakeholder in the litigation requires careful consideration by the judge case managing the class action.

99 Most recently, see Fairview Donut Inc. v. The TDL Group Corp., 2012 ONSC 1252 (CanLII) at para 357.

100 Fairview Donut Inc. v. The TDL Group Corp. (n 99) para 361.

101 Interview with respondent 6 (n 88).


103 Rossos (n 102) 119.
Potential overreaching by the funder as well as subtle pressure on counsel to take a course of action that is at odds with the interests of the class both affect the independence of counsel. The funder, potentially carrying a portfolio of cases – perhaps with the same class counsel – may have different risk tolerances than those of the representative plaintiffs and class members; it is therefore no answer to say simply that the interests of the funder align with those of the class. These concerns are more pronounced where counsel and the funder have an ongoing business relationship in a number of concurrent or potential actions. It is unclear whether close judicial supervision is sufficient to guard against improper interference by the commercial financier.

iii. Financial Exploitation

The third concern in the champerty analysis, the potential overcompensation of the funder, is also capable of being addressed through judicial oversight. Concerns about the financial exploitation of the class by funders have been partly assuaged by negotiated caps on the levy to be charged by the funder, and a percentage on return that is less than the Class Proceedings Fund’s 10% levy. As explored with the lawyers interviewed for this paper, however, the market rates for TPLF will vary according to the amounts advanced. The contracts approved in Dugal and Hobshawn were mainly indemnity agreements, with only modest disbursement funding. Where funding arrangements include financing of disbursements and/or legal fees, the levy will exceed 10%. In those cases, the comfort provided by the Class Proceedings Fund benchmark will disappear, and judges will be left with the difficult task of assessing what levy is high enough to compensate the funder for the risks borne, but not so high as to amount to financial exploitation.

d. Regulation by Litigation

The de facto regulator of TPLF, at least for the foreseeable future, is the class action judge. There has been no legislative movement toward regulating the TPLF industry as a whole. The Law Society of Upper Canada, the body charged with regulating the legal profession in Ontario, examined the issue briefly in 2006. A subcommittee identified potential areas of concern, including conflicts of interest arising from the lawyer’s interest in receiving payment through a funding vehicle and contractual provisions that may interfere with representation of the client. The subcommittee was of the view that the Law Society should continue to monitor developments, and suggested that it may ultimately need to recommend a regulatory response. Convocation ultimately decided to take a “watch and wait” approach. No regulatory response has since been proposed.

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104 A number of commentators have made this claim. See eg Burch (n 131) 4 and Rossos (n 102) 108.

105 On this point, I disagree with Lyon who has argued that if the attorney can overcome his own pecuniary interest in a lawsuit (by virtue of the contingency fee], then he can “overcome his concern for the interests of a third party to whom he is not otherwise beholden”: Lyon (n 135) 608. The creation of a market in TPLF and of repeat players as between funders and class counsel renders counsel at least somewhat ‘beholden’ to his or her financier.

In the absence of attention by the Law Society of any province, the courts will be charged with crafting guidelines and governing principles in this burgeoning field. For judicial oversight to be effective, transparency of the funding arrangement to at least the case management judge will be critical, a concept to which all participants who were interviewed for this paper were committed in one form or another. Strathy J. expressly stated that he was acting as a proxy for consents by individual (prospective) class members, and the court, therefore, must scrutinize the arrangement. In Australia, the biggest commercial funder, IMF, advocates for full, public and mandatory disclosure of funding agreements. All lawyers interviewed for this paper were of the view that the funding agreement should be approved by the case management judge; unlike a law firm’s other banking arrangements, the involvement of a third party funder, and its contractual relationship with the representative plaintiff, must be disclosed to and approved by the class action judge.

The timing of, and participants in, the approval motion, however, are the subject of much debate in Canada. While most respondents maintained that the agreement should be submitted to the judge for approval early in the action, one respondent argued that it would be more appropriate to disclose the agreement at the end of the litigation, concurrently with class counsel’s fee. Another respondent opined that in every class action, the Public Trustee, Children’s Lawyer, and the Class Proceedings Fund ought to be put on notice and permitted to appear at the approval motion, the first two entities because of their statutory obligation to protect the interests of persons under disability and minors, respectively, both of whom may be class members, and the latter because of its interest in the question of funding litigation.

The role of the defendant in the approval hearing is even more controversial. The majority of the lawyers interviewed claimed that divulging any details of the funding agreement to the defendant undermines the plaintiff’s strategic advantage in obtaining such support. Other lawyers interviewed for this paper characterized such a concern as

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107 Respondent 7 questioned whether judicial approval at the outset of the litigation was even necessary; so long as the settlement approval or trial judge was aware of the terms of the agreement at the conclusion of the case for the purposes of assessing the risk profile of the action and the quantum of counsel fees, this respondent did not see the need to “expose our financial flank” early in the litigation.


109 Respondent 7 (n 79). The primary reason offered was to avoid losing any strategic advantage to the defendant through the early disclosure of the terms and extent of the funding arrangement.

110 Respondent 8 (n 83).

111 Respondents 1, 2, 4, 6 and 7. Respondent 3 had no intention of seeking third party funding and had no opinion on the issue of ex parte approval. See also Victoria Paris and Megan McPhee, “Class Actions – Plaintiff”, online: http://www.lexpert.ca/500/practice-areas/recent-developments/article/class-actions-l7b/.
“paranoid”; the defendant’s knowledge that the plaintiff is well-funded and backed by an indemnity can only increase the plaintiff’s leverage.112

Counsel in Dugal and Metzler proceeded on notice to the defendant, who made submissions to the judge. Subsequent to obtaining approval in Dugal, the funder’s principal stated that he and class counsel involved defence counsel in order to improve the chances of securing Strathy J’s approval, but that they would have more confidence proceeding ex parte in subsequent cases.113 Such confidence is misplaced given a very recent Ontario decision. In Fehr v. Sun Life,114 the plaintiffs moved for directions regarding the procedure for approval of a funding arrangement. The plaintiffs argued that the motion should be closed to the public, argued without notice to the defendant, and that all documents for the motion be sealed, all on the basis that the third party funding agreement discloses elements of their litigation strategy and is therefore subject to solicitor-client and litigation privilege. As a matter of public policy, the plaintiffs submitted that excluding Sun Life from the motion would result in no prejudice to the defendant, and would increase the plaintiffs’ access to justice by denying the defendants the tactical advantage of knowing the plaintiff’s available resources and risk tolerance.

Perell J. found that in the context of class actions, the terms of both counsel’s retainer agreement and the associated third party funding agreement are not privileged.115 He further held that in the context of an adversarial system of justice, the defendant’s views about the agreement will provide the Court with useful information, obviating the need to appoint an amicus.116 Importantly, the judge rejected the argument that access to justice would be undermined by disclosure of the contract to the defendant, either through the loss of strategic advantage or because the funder may choose not to provide funding if the approval motion is heard in open court. “[N]o litigant is entitled as of right to have all economic barriers to access to justice removed. As for BridgePoint, if it 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.”117

In the still largely unexplored legal territory of third party funding of class proceedings, there are other ethical challenges yet to be addressed by either the courts or law societies. First, the extent to which plaintiff’s counsel may divulge privileged information to a prospective funder – either the class members’ information, protected by solicitor-client or litigation privilege, or the defendants’ information, protected under the

112 Respondent 5 (n 87). Respondent 8 stated that it was “wrong” to proceed on an ex parte basis.

113 “Enter the Silent Partner” (n 8) 61.


115 Fehr v. Sun Life (n 114) para. 8.

116 Fehr v. Sun Life (n 114) para. 110.

117 Fehr v. Sun Life (n 114) paras. 154-155.
deemed undertaking rule – have thus far been left to the discretion of a particular judge in an individual case. Further to an agreement between the parties, Strathy J. ordered the plaintiff to obtain permission from the defendant before divulging evidence obtained from that defendant to the funder and further, that the funder would be deemed to undertake not to use that evidence for any purpose outside the litigation as if it were a party.\textsuperscript{118} Whether Strathy J. would have so ordered absent the consent of the plaintiff is unknown. Moreover, the question of client confidentiality was not addressed in \textit{Dugal}. Is the funder, for example, entitled to what is otherwise solicitor-client privileged information? Does disclosure of such information waive solicitor-client privilege, as has been suggested by American scholars\textsuperscript{119} and the American Bar Association?\textsuperscript{120}

Second, the extent of judicial supervision over the funder-counsel-class relationship remains untested. Apart from the initial approval of the funding agreement, what is the court’s jurisdiction to regulate the conduct of the funder? New Zealand’s Rules Committee, for example, has introduced a Bill that expressly recognizes the necessity of judicial supervision of funders in order to protect the interests of class members.\textsuperscript{121} Among other requirements, the Bill stipulates that a proposed representative plaintiff must file affidavit evidence disclosing existing or prospective funding arrangements.\textsuperscript{122} The judge, even after initially approving the funding agreement and where she is satisfied it is just to do so, has the express authority to vary the agreement either on her own initiative or at the request of a class member.\textsuperscript{123}

In contrast, none of Canada’s class action legislative regimes dictate that disclosure of the TPLF agreement must be made prior to certification, or that the agreement, once approved, may be reopened or varied at a later point in the litigation. Class proceedings legislation also does not expressly empower judges to adjudicate disputes between the funder and class members or counsel, which as a matter of contract may be addressed by mandatory arbitration clauses.

Unlike Australian courts,\textsuperscript{124} Canadian courts have been firm in their rejection of a funder’s contractual right to exercise any control of the conduct of the litigation. The

\begin{enumerate}
\item Dugal v Manulife Financial Corporation, 2011 ONSC 3147 (CanLII) para 4. For a discussion of the implied undertaking rule and its rationale in Canada, see Juman v Doucette 2008 SCC 8.
\item Maya Steinitz, ‘Whose Claim is it Anyways: Third Party Litigation Funding’ (2011) 95 Minnesota Law Review 1268.
\item Morabito and Waye (n 45) 337.
\item Morabito and Waye (n 45) 338.
\item Morabito and Waye (n 45) 339.
\item Campbells Cash and Carry Pty Ltd v Fostif Pty Ltd [2006] HCA 41 at 89-91.
\end{enumerate}
agreement in *Dugal* provided that class counsel was to be instructed only by the representative plaintiff. This provision, however, is fragile for at least two reasons. First, as many commentators and few judges have acknowledged, the notion that the representative plaintiff controls the litigation is a fiction. The representative plaintiff and class members typically have very little incentive to actively monitor class counsel given that counsel’s financial stake and risk in the litigation is out of all proportion to those borne by the individual class members. Second, the ability of the representative plaintiff in a commercially funded class action to leverage her power to fire class counsel if her interests are disregarded, as occurred in *Fantl v. Transamerica Life*, is muted by virtue of the funder’s ability to terminate the funding agreement if class counsel is replaced. Furthermore, this termination provision, blessed by Strathy J in *Dugal*, differs only in degree from a term in a retain agreement preventing a litigant from changing counsel. Terms that limit the right of a client to discharge counsel are, of course, prohibited by rules of professional conduct.

Notwithstanding the court’s power to regulate certain aspects of the TPLF arrangement, there remains a role for the legislature and the bodies regulating the legal profession. Questions for the legislature include minimum capital requirements; application of consumer protection laws, insurance and banking regulations or the securities regime; and caps on fees or effective interest rates.

For law societies, important questions to be considered include independent legal advice requirements for the representative plaintiff; disclosure obligations to the plaintiff and to the court regarding the relationship between the lawyers and the funder; compliance with law society by-laws that stipulate affiliations with non-members in the delivery or promotion of legal services must be disclosed to the regulator with detailed information about the affiliation; compliance with rules protecting the client’s right to freely choose counsel; and the conflicts of interest that may arise where the lawyer has an interest either in receiving payment through a funding vehicle or in the funding entity itself.

Notwithstanding the number of issues yet to be addressed by either courts, the profession’s regulators or legislatures, the Canadian approach to the emerging TPLF market in class actions can be characterized as one of cautious acceptance. Courts have signified a clear need for transparency and protection of litigants’ interests. While academics and others in the U.S. have sounded a similar alarm, far less judicial and regulatory attention has been devoted to the American TPLF market.

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127 ABA (n 120) 21; Ontario Rules of Professional Conduct, Commentary to rule 2.09(1) [“the client has the right to terminate the lawyer-client relationship at will”].

128 Part IV of By-Law 7 made under subsections 62 (0.1) and (1) of the Law Society Act, RSO 1990, c.L-8.
IV. The United States of America

In contrast to Canada’s relatively brief history with TPLF, the TPLF market in the U.S., like Australia, is a few decades old and still growing rapidly. The last decade has seen marked increases in the number of funders entering the market and the types of cases in which these funders are willing to invest. The expansion of TPLF in the U.S., from its roots in personal injury and small tort claims to complex commercial litigation funding, however, has resulted in a much different TPLF regime than those which exist in Australia and Canada. Most markedly, there does not appear to have been a reported instance of TPLF in the class actions context in the U.S. to date.129

a. Origins of Litigation Funding

In the U.S., many attorneys rely on the contingency fee model or on fee-shifting arrangements allowed under various statutes in order to fund the litigation.130 However, the recent convergence of unfavourable economic conditions, the consequent desire for sound investment prospects, and the enormous resources presented by the litigation market have created the perfect opportunity for the entrepreneurial investor. Some attorneys have been happy to move away from the contingency fee and embrace funding from a third party as a means of diminishing their own personal and financial risk. In doing so, however, both funders and attorneys have had to grapple with pre-existing bars on such arrangements, prompting strategic forum choices, lobbying for rule reform and general secrecy surrounding TPLF agreements.

Unlike Australia, where the practice is prohibited, contingency fees have existed in the U.S. for many years. In the current economic climate, however, lawyers and their firms find themselves lacking both the capital and the taste for risk-taking that would earlier have propelled them to accept cases on a contingency basis. Likewise, the economic downturn has also had the effect of making other traditional sources of funding, such as banks, a

129 While there have been reported instances of individuals obtaining TPLF in return for a share of their damages arising from a class action suit, these are individual contracts and not agreements to fund the entire class. See e.g. MoneyForLawsuits VLP v Rowe, 2012 WL 1068760 [summary judgment granted by the United States District Court for the Eastern District of Michigan in favour of lender who sued for payment under a funding agreement with eight litigants].

130 Most countries operate under a "loser pays" system, whereby the losing party pays the prevailing party's legal costs. This is also referred to as the "English Rule." The United States, however, operates under the "American Rule," which "provides that the prevailing party must bear his own attorney's fees and cannot have them assessed against the loser." Chambers v NASCO, Inc 501 U.S. 32 (1991). Fee-shifting, permitted by some statutes, is an exception to the American Rule because it allows the prevailing party to recover fees from the losing party. As of 1994, there were over 150 federal fee-shifting provisions. McLendon v Cont'l Group, Inc, 872 F Supp 142, 150 (DNJ 1994). Fee-shifting, has received congressional approval under such statutes as the Civil Rights Act of 1964, 42 US C § 2000e-5(k) (2006); the Americans with Disabilities Act, 42 US C § 12205 (2006); the Privacy Act of 1974, 5 US C §§ 552a(g)(2)(B), (g)(3)(B) (2006); the Government in the Sunshine Act, 5 US C § 552b(i) (2006); the Equal Access to Justice Act, 28 US C §§ 2412(b), (d) (2006); the Clean Air Act, 42 US C § 7607(f) (2006). See also Charles Silver, 'Due Process and the Lodestar Method: You Can’t Get There from Here' (2000) 74 Tulane Law Review 1809, 1813.
scarce commodity. Thus, the climate has been ripe for the pairing of risk-adverse lawyers and firms with entrepreneurial funders. The TPLF arrangement has allowed lawyers and firms to remain solvent, alleviate cash flow problems, and overall to remain competitive with firms that have more capital.

Alternative funding for litigation in the U.S. originated with the financing of personal injury actions by third parties. Personal injury and other civil tort actions involve substantial sums and represent a large portion of the overall spending on litigation nationwide. Indeed, personal injury and individual-plaintiff tort actions still make up the lion’s share of the litigation funding that goes on in the U.S. today. Unlike Australia, there is little evidence that TPLF is significant in class action litigation.

b. Current Practices

The various types and structures of U.S. TPLF arrangements vary significantly from those found in Australia and in Canada. The U.S. has recognized three distinct types of third-party funding arrangements: nonrecourse loans made directly to plaintiffs, loans to lawyers or law firms, and funding of complex or commercial claims.

i. Nonrecourse Loans to Individual Plaintiffs

Given their roots in tort and personal injury actions, the earliest litigation funding arrangements consisted of loans made directly to plaintiffs. Tort and personal injury actions still occupy a significant share of the litigation funding market, although this proportion is shrinking as the two other categories of litigation funding gain popularity. Individual-plaintiff action funding typically consists of a cash advance to the plaintiff to cover the cost of the litigation itself, and in some instances to cover other expenses such as living costs in anticipation of a settlement of successful outcome. The loan is secured solely by the claim.


134 These three categories have been recognized repeatedly in the literature. See e.g. Steinitz (n 119); Garber (n 132); Burch (n131); ABA (n 120) 7.


According to the RAND Report on Alternative Litigation Financing in the United States, the average size of a cash advance tends to be less than 10 percent of estimated values of the underlying claim and typical interest rates on individual plaintiff action loans are in the range of 2% to 5%.\(^{137}\) However, much higher interest rates on nonrecourse loans (as high as 20%) have been reported elsewhere.\(^{138}\) The lenders acknowledge that the rates are high, but state that rates are calculated and based on the specific facts of each individual case; namely the risk to the lender, the return expected and the amount required to sustain the claim.\(^{139}\) The nonrecourse character of the loans allows the arrangements to circumvent usury laws, which bar ultra-high interest loans, making them permissible in most states.\(^ {140}\)

**ii. Loans to Lawyer and Law Firms**

As the market surrounding financing of tort and personal injury actions expanded, funders also began exploring other financing arrangements. The practice of providing the loans to the plaintiff’s lawyer or law firm as opposed to the plaintiff themselves emerged.\(^ {141}\) Some scholars suggest that at present, the practice of lending directly to the firms has in fact become more prevalent than the nonrecourse loan arrangements,\(^ {142}\) which are made by third-party funders directly to lawyers or law firms.\(^ {143}\) They are typically secured by the firm’s assets and may include settlements and judgment from the firms’ other cases.\(^ {144}\) Under this model, the lawyers or firms must repay the loan, regardless of the outcome of the case.\(^ {145}\) The interest rates, although largely unknown, are thought to be upwards of 20%.\(^ {146}\)

\(^{137}\) Garber (n 132) 12.


\(^{140}\) Burch (n131) 35. A minority of states, however, continue to apply usury laws to non-recourse loans, or loans in which the repayment is contingent. See e.g. *Odell v Legal Bucks, LLC*, 665 S.E.2d 767 (NC App 2008) cert. denied 676 S.E.2d 905 (NC Apr 30, 2009). The Appeals court ruled that Legal Bucks, a NC litigation-funding company had violated state usury laws by charging the plaintiff more than 16% interest. The court held that the state usury laws still applied, regardless of the fact that the repayment was contingent on the outcome of the lawsuit.

\(^{141}\) Burch (n131) 35; Richmond (n 178) 650.


\(^{143}\) Garber (n 132) 13.

\(^{144}\) Burch (n 131) 35.

\(^{145}\) Garber (n 132) 10.

\(^{146}\) Garber (n 132) 13.
iii. **Complex and Commercial Litigation Funding**

The third and most recent category of litigation funding is the investment in complex and commercial actions. While there appears to be an abundance of lenders offering loans to individual plaintiffs or to lawyers and their firms directly, given the increased risk, the world of commercial claim funders is a much more limited group.\(^\text{147}\) Reports put the number of major litigation lenders in the U.S. at roughly 19.\(^\text{148}\) Two of these lenders, Juridica Investments and Burford Capital, are publicly traded on the London Stock Exchange but invest mostly in U.S. intellectual property, commercial and antitrust actions and, as of 2010, reportedly managed assets upwards of $200 million.\(^\text{149}\)

Complex and commercial litigation funders are companies whose sole business is to finance litigation. These funders typically obtain their capital from groups of investors ranging from hedge fund managers to various types of private investors.\(^\text{150}\) The lenders are under no obligation to disclose the means by which they raise capital, nor the identity of their investors. At the time of writing it was suggested to us by one U.S. funder that some of those seeking capital for litigation funding in the United States market are experiencing some difficulties, possibly in part due to the relatively long average lead time between investment and return.

The lenders often solicit individual plaintiffs (most common for tort actions), or plaintiff’s lawyers or law firms (more common for commercial, patent, intellectual property and international matters) who have pending litigation that may be of interest to them. Some lenders are called upon late into the litigation process to step in and provide financial resources to cover outstanding arrears or to pay the lawyers’ fees simply to keep the litigation afloat.\(^\text{151}\) In addition to providing funds directly to the lawyer or the client, at least

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\(^{147}\) Lyon (n 135) 578.

\(^{148}\) Juridica, Burford and Credit Suisse are perhaps the three most well known and well established litigation lenders in the U.S. Garber (n 132) 10. However, Credit Suisse is no longer involved. In his paper for the RAND Institute for Civil Justice, Steven Garber listed nine more litigation investment companies: Advanced Legal Capital, Advocate Capital, Inc., Counsel Financial, Evergreen Funding Group, LawFinance Group, Inc., Oxbridge Financial Group LLC, Rapid Funds, RD Legal Capital, and ViaLegal Funding. Elizabeth Chamlee Burch named several others in her December 2011 article: Amicus Capital Services, LLC, BridgePoint Financial Services, LawsuitLoanHQ, Trimark Capital Funding, Inc. Most recently, the Australian litigation funding giant IMF has launched a U.S. division called Bentham Capital LLC. In a December 9, 2011 presentation announcing its expansion, Bentham Capital’s Director Ralph Sutton named at least two more up and coming lenders: BlackRobe and Fulbrook. Sutton also reported the emergence onto the U.S. market of litigation lenders from the UK. Sutton (n 166).

\(^{149}\) Jonathan Molot, ‘Theory and Practice in Litigation Risk’ (2012) Burford Whitepaper 7 <http://www.burfordfinance.com/en> accessed 8 May 2012 (Malot reports that Burford has committed over $280 million to over 35 cases, including U.S. commercial litigation, international arbitration, and other non-U.S. litigation). See also, Garber (n 132) 13; Burch (n 131) 36.


\(^{151}\) Molot (n 149) 8 (in these situations, the funds are deposited directly into the trust account for the individual client).
one funder has also reported having stepped in to provide the funds necessary for one of its clients to keep an insurance policy up to date and in place. Going forward therefore, the funder and the insurance company together shoulder the risk of the litigation ending unsuccessfully.\textsuperscript{152} Lenders gauge their interest level on the merits of each case, deeming claims “meritorious” if they are likely to yield damages or settlements large enough to allow them to recover the cost of their loan with interest as well as a healthy surplus.\textsuperscript{153} Baker McKenzie, a major international law firm, described the typical commercial funding arrangement as one whereby

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ap a specialist funding company \ldots\ pay[s] the lawyers’ fees on an interim basis.  
\ldots If you win, you pay a contingency fee out of the damages, usually expressed as a percentage of the damages up to an agreed cap. A typical contingency fee would be between twenty and fifty percent of the damages, with a cap of three to four times the legal costs advanced by the funder.\textsuperscript{154}
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Little else is known about the details of arrangements with commercial lenders. Most funders refuse to disclose which claims they have elected to fund because they are bound by confidentiality agreements contained in the terms of the loan. In fact, many clients want to prevent disclosure of the fact that they have sought funding at all.\textsuperscript{155} Additionally, although there are currently no local court rules that would require the disclosure of the details of a financing arrangement between a litigant and a third party,\textsuperscript{156} lenders want to avoid the possibility that the funding arrangement could become an issue in the litigation (as became the case in in \textit{Fehr v. Sunlife} in Ontario) by keeping the arrangement out of court altogether.\textsuperscript{157}

It would appear that the nature of the commercial arrangements entered into by funders in commercial cases vary as between funders and funded cases. In some instances the lawyers conducting the cases assume some of the risk of non payment of fees and may contribute some of the funding to cover the expenses of the litigation. Where funders meet all of the expenses of conducting the litigation (including attorneys’ fees) they would normally be expected to seek a higher return for that outlay and risk.

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\textsuperscript{152} Ibid.
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\textsuperscript{153} McLaughlin (n 150) 620.
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\textsuperscript{155} Molot (n 149) 8.
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\textsuperscript{157} Lindeman (n 156) 4-5.
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Commercial lenders rarely disclose their interest rates. This enables the funders to charge whatever they like, without fear of accountability or regulation. Consequently, there is little chance for plaintiffs to assess or compare rates among competing funders. The secrecy surrounding the particulars of funding agreements with commercial lenders makes any attempt to identify an average interest rate extremely difficult. Reports are so wide ranging that any attempt at identifying a trend is more or less futile given the limited data available. The total amounts that commercial funders are willing to spend on litigation funding are equally difficult to ascertain: one statistic estimated that for litigation involving corporate entities, funding can reach up to $15 million and cases can be valued at $100 million or more.

With very few exceptions, litigation funders support primarily plaintiff-side efforts. However, a few lenders have expressed interest in expanding into providing funding to defendants and their lawyers as well. Commercial lenders have stated that it would be primarily the merits of the claim, rather than the identity of the recipient of the funds, that would be of most concern in selecting a claim to fund. At least one significant funder has stated that the experience and reputation of the attorneys involved in the litigation are as important as the merits of the litigation.

Among the types of cases that are most attractive to litigation funders are anti-trust or price fixing cases, patent litigation, and commercial, international, and other

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158 Barksdale (n 139) 731-732.
159 Barksdale (n 139) 732.

<http://www.law.com/jsp/nlj/PubArticleNLJ.jsp?id=1202435837230&Litigation_funding_begins_to_take_off_by_subscription> accessed 20 February 2012.
161 See Lindeman (n 156) 3; ABA (n 120) 7; Hensler (n 142) 322.
162 Lindeman (n 156) 3. Lindeman reports that Selvyn Seidel of Burford Capital has no apparent preference for funding plaintiffs over defendants, rather, the lender is more concerned with finding good claims rather than bad claims.
164 These cases are attractive because they are perceived as low risk with the potential for high damage awards. Also, these cases are typically brought subsequent to criminal prosecution by the U.S. Department of Justice or an early settlement by one of the cartel members. See Lindeman (n 156) 3.
165 Regarding patent litigation, Juridica Investments Ltd., a large investment firm, said “the cost of patent litigation was often significantly higher than the purchase price of a patent or portfolio of related patents.” As such, Juridica acquires the patents outright and then contracts with the law firm to handle the litigation. Lindeman (n 156) 3.
intellectual property cases.\textsuperscript{166} There have been a few major non-class aggregate lawsuits funded by third parties: the World Trade Centre Respiratory Illness lawsuit brought on behalf of ground zero workers was funded by Counsel Financial in the form of a loan to Napoli Bern LLP (the case eventually settled for $712.5 million, and the lenders earned approximately $11 million).\textsuperscript{167} Additionally, Burford Financial is funding thousands of Ecuadorean plaintiffs in their controversial personal-injury battle against Chevron.\textsuperscript{168}

To date, there appear to have been no reports of third-party funding of class actions and the two biggest funders have declared their intentions to avoid class litigation altogether.\textsuperscript{169} Juridica has specified that it avoids funding class actions\textsuperscript{170} and Burford has stated that although it would not be opposed to funding class actions, it has chosen not to do so to date.\textsuperscript{171}

The reasons for the relative inactivity of TPLF in class action litigation are likely threefold. First, class action attorneys have long been able to recover significant fees from settlement funds, subject to court approval and calculated either as a percentage of recovery or the lodestar method. The size of these fee awards has enabled some counsel to build sizeable war chests, and they therefore do not need third party funding, or are unwilling to reduce their profit margin by splitting their fees with a funder. Second, unlike the Canadian and Australian civil justice systems, there is no risk of paying a successful defendant’s costs, and thus no need to supply or purchase a costs indemnity for representative plaintiffs. Finally, in the context of battles between lawyers for the right to represent the class, which are more numerous in the U.S. than in the other two jurisdictions, the inability of class counsel to self-fund may be fatal to lead counsel status.\textsuperscript{172}

\begin{footnotesize}
\textsuperscript{166} Ralph Sutton, ‘Overview of IMF expansion strategy for US market: Presentation to Investors’ (Online Presentation Broadcast, Bentham Capital, December 9, 2011, 4:00pm) <http://www.brrmedia.com/event/89940> accessed 21 February 2012.


\textsuperscript{169} Hensler (n 142) 323; Lindeman (n 156) 3.


\textsuperscript{172} We are grateful to Ralph Sutton for alerting us to this point and for his helpful comments on the article generally.
\end{footnotesize}
Nevertheless, there may yet be a role for funders in class action litigation. As Deborah Hensler has posited:

The entrance of third-party litigation funders into the U.S. legal marketplace...might increase the number of law firms willing to prosecute class actions, increase competition among firms for class counsel appointments, and increase investment by class counsel in pretrial development of facts and law. The results might include increased numbers of class actions and higher-value settlements.\footnote{Hensler (n 142) 322-23.}

Philosophical objections to any initiative that would increase litigation, and ethical concerns regarding the impact of TPLF on the solicitor-client relationship, need to be overcome before TPLF gains a foothold in the U.S. class action market.

c. Ethical Concerns

U.S. commentators express all of the same concerns regarding TPLF that we have encountered in our discussion of the Australian and Canadian regimes. First, remnants of the ancient doctrines of maintenance and champerty, the most frequently cited objection to TPLF in both the personal injury and commercial context, have slowed the expansion of TPLF. A second principle concern is the integrity of the lawyer-client relationship. There is an apprehension that the introduction of a third-party into this relationship compromises confidentiality, impartiality, professional judgment and ultimately the client’s control over the litigation. Third, there is concern that lack of proper monitoring of third-party funding arrangements will result in abuses perpetrated by the lenders or the lawyers on the claimants. The fear is that, if unaddressed, such ethical violations will eliminate the “equalizing effect” that third-party funding was intended to create.\footnote{Steinitz (n 119) 1323.} In other words, the advantages to the client presented by third-party funding, namely access to justice and increased bargaining power, could all be lost if lenders and lawyers are engaging in unethical practices within the context of the funding arrangements.

i. Maintenance and Champerty

In Canada and Australia, the application of the laws of maintenance and champerty is being assessed in the courts. In most Australian jurisdictions the tort and crimes of maintenance and champerty have been abolished. Perhaps more than its counterparts, the U.S. has been disinclined to modify these laws. In some jurisdictions, such as Australia, while maintenance and champerty are no longer torts or criminal offences residual restrictions on arrangements which may constitute abuse of process remain. By contrast, the U.S. has relatively few judicial decisions addressing these issues directly. Rather, the laboured repealing of the antiquated concepts of maintenance and champerty entrenched in individual state statutes has occurred slowly, state by state.
The American Bar Association Commission on Ethics 20/20 (ABA Commission) ‘White Paper on Alternative Litigation Finance’ offers the most comprehensive review to date of the status of maintenance and champerty laws vis-à-vis litigation funding. It reports that 29 out of 51 jurisdictions now permit some form of champerty or maintenance in situations of third-party litigation funding.\(^\text{175}\) For the most part, “American courts [have] held that the risk that third parties would engage in what is today known as abuse of process had disappeared with the advent of modern reforms”\(^\text{176}\) and that prior prohibitions on the involvement of a third-party in the direction of an action has yielded to the use of third party finding as a “socially useful way to resolve disputes.”\(^\text{177}\) The initiation of the repealing of these laws can be traced to the original acceptance of contingency fees. Today, all 50 states have carved out express exceptions to maintenance and champerty to allow for contingency fees.\(^\text{178}\) However, laws prohibiting the sharing of fees with non lawyers and restrictions on the involvement of non-lawyers in the conduct of litigation remain; funders may therefore insist upon contracting directly with the client in order to circumvent the prohibition on sharing fees with a lawyer by having an agreement with a client to receive a share of the proceeds received by the client rather than a share of the fees received by the lawyer.

Of particular note on the American landscape is that the majority of cases dealing with these laws on the state level appear to have been tort actions for personal injury claims. There appears to have been little if any judicial consideration of the validity and legality of third party funding of commercial claims. Likewise, the use of third party funding in aggregate litigation has received little judicial scrutiny. Exceptionally, in the World Trade

\(^{175}\) ABA (n 120) 10-13. The stated reasons for the repealing of maintenance and champerty vary: the ABA reported that some states (Arizona, California, Connecticut, Missouri, New Jersey, New Hampshire, New Mexico and Texas) have taken the position that maintenance and champerty laws were never actually adopted from the English common law. In other states, although originally adopted, the prohibitions on maintenance and champerty have simply been abandoned (namely in Massachusetts, and South Carolina and Colorado, although in the latter, one court recently disapproved of the assignment of a claim on the basis of champerty principles: Espinosa v Perez, 165 P3d 770, 773-74 (Colo. Ct. App. 2007).). A Florida court has ruled directly on the topic, pointedly overruling and abolishing maintenance and champerty. See e.g. Kraft v. Mason, 668 So 2d 679, 682 (Fla Dist Ct App 1996). In Ohio, as recently as 2003, that state’s Supreme Court in Rancman v Interim Settlement Funding Corp, 99 Ohio St 3d 121, 123 (2003) barred a third-party funding arrangement citing maintenance and champerty, practices that had traditionally been “vilified” in Ohio. However the state legislature nullified the decision in 2008 and enacted a statute specifically allowing third-party funding in the consumer financing context. Maine and Nebraska have followed suit. See Non-Recourse Civil Litigation Advances, Ohio Rev Code Ann § 1349.55 (West); Maine Consumer Credit Code Legal Funding Practices, Me Rev Stat tit 9-A, § 12 (2009); Nebraska Nonrecourse Civil Litigation Act, Neb Rev St § 25-3303 (West 2010).

\(^{176}\) ABA (n 120) 10.

\(^{177}\) Saladini v Righellis, 687 NE2d 1224, 1226 (Mass 1997).

Center settlement, the court refused the plaintiffs’ attorneys’ request to recoup the funders’ interest and other expenses from the settlement proceeds.\footnote{Mireya Navarro, “Judge Rejects $6.1 Million in 9/11 Case Legal Fees” The New York Times (August 27, 2010), online: http://www.nytimes.com/2010/08/28/nyregion/28lawsuit.html.}

Given the relatively shrouded nature of the practice in the U.S., many lawyers are still grappling with the unique ethical challenges presented by these arrangements.\footnote{ABA (n 120) 2.}

\textit{ii. Control of the Claim and Preservation of the Attorney-Client Relationship}

The unique relationship created in a TPLF arrangement carries with it a perceived danger that the client’s control over her own claim could be undermined by the involvement of the funder. This concern was reflected by the ABA Working Group in its White Paper. The Group identified a number of the Model Rules of Professional Conduct concerning the attorney-client relationship that have the potential to be compromised in a third-party funding arrangement.\footnote{ABA (n 120) 4. The ABA has stated that attorneys must be mindful that third-party funding arrangements do not violate the following Model Rules of Professional Conduct R.21 (2009): 2.1 requiring independent professional judgement, 1.8(e) which prohibits lawyers from offering financial assistance to clients, 1.8(f) which bars a lawyer from receiving compensation from a third-party, 5.4(c) which prevents lawyers from letting third-parties influence the direction of an action.}

For instance, a lender may seek information about a client’s case as part of its vetting process. Once disclosed to the funder, there is a risk that the information in question will no longer be covered by the attorney-client privilege, and although perhaps protected by the written agreement between the two (via the confidentiality agreement or nondisclosure agreement) it would not be immune from production at a discovery or future hearing.\footnote{For example, ALFA, Juridica and Oasis Legal Finance have all indicated that they do not seek access to information covered by the attorney-client privilege when performing due diligence prior to funding a claim. See American Bar Association Working Group, ‘Working Group’s Issue Paper Concerning Alternative Litigation Financing’ (American Bar Association Comments, 2011) <http://www.americanbar.org/content/dam/aba/migrated/2011_build/ethics_2020/comments_on_alternative_litigation_financing_issues_paper.authcheckdam.pdf>.}

The question of whether any communications at all with the funder would be covered by the privilege, thus exposing the plaintiff to even more risk, is also unsettled.\footnote{Bray & Gillespie Management LLC v Lexington Insurance Co, 6:07CV222-ORL-35KRS, 2008 WL 5054695, 2 (MD Fla 2008). This case is one example of the court considering this question: the defendant insurance company had sought to depose the plaintiff’s CEO about his discussions with Juridica regarding possible financing of the claim. Counsel for the plaintiff objected on the grounds that the discussions were privileged. The judge did not rule on the objection but rather noted that the state law governing attorney-client privilege required a showing that the party receiving the privileged information was “a member of the bar . . . or his representative [who] in connection with this communication [was] acting as a lawyer.”}
In one recent case, the Delaware court rejected the common interest exception to attorney-client privilege and ordered disclosure of documents shared with funders during discussions about potential funding.\textsuperscript{184} Yet in another decision, a Texas court found that disclosure of such documents to potential funders did not waive work product privilege.\textsuperscript{185}

Third party funding also presents potential for interference with the lawyer’s professional judgment.\textsuperscript{186} When the lending is to the lawyers directly, rather than clients, the lawyer becomes accountable to someone other than her client, raising a potential for conflict.\textsuperscript{187} Although one major funder has publicly disclaimed any role in the selection of counsel, the direction of the litigation or the decisions regarding settlement,\textsuperscript{188} and another has contended to us that generally litigation funders do not exercise such control,\textsuperscript{189} it is difficult to imagine that in all cases of TPLF the holder of the purse strings would have no influence over the direction and outcome of the litigation.

Finally, in the case of commercial actions, the lenders themselves may also be beholden to their own investors or shareholders, who may exert pressure on the funders and seek the expeditious and early settlements of the claims in order to be able to report higher quarterly profits.\textsuperscript{190}

### iii. Monitoring and Protection of the Client

Third party funding on the whole is a fairly secretive endeavour. By way of contrast, the publicly listed litigation funder in Australia, IMF, publishes details of funded cases and funding agreements on its website and is subject to stock exchange disclosure requirements. Conversely, while some U.S. funders may disclose yearly profits or growth margins, and at most, their total annual investment in litigation,\textsuperscript{191} the funders themselves rarely reveal details of individual cases.

Absent any regulatory obligation, there may be no incentive (other than strategic marketing) for the funders to disclose any details of their practices. Unlike Australia, there

\textsuperscript{184} Leader Technologies, Inc. v. Facebook Inc., 719 F.Supp. 2d 373 (D. Del. 2010).

\textsuperscript{185} Mondis Technology Ltd. v. LG Electronics, Inc., 2011 WL 1714304 (E.D. Tex. May 4, 2011). We thank Ralph Sutton for alerting us to this decision.

\textsuperscript{186} ABA (n 120) 23-24.

\textsuperscript{187} Lyon (n 135) 607.

\textsuperscript{188} Molot (n 149) 7, 11 (Burford’s Chief Investment Officer repeatedly stated his fund’s position on preserving the lawyer’s control over the litigation, including the attorney-client relationship, in his recent Whitepaper).

\textsuperscript{189} Telephone interview of Ralph Sutton (16 May 2012), who described the concern about control as a ‘phantom issue’.

\textsuperscript{190} Steinitz (n 119) 1319.

\textsuperscript{191} See the limited information provided by Burford in its annual report available at <http://www.burfordfinance.com/en>.
is no precedent or common practice that would require disclosure of a third party-funding arrangement to a judge or to the opposing litigants. As such, there is virtually no monitoring of TPLF and its effects on the individual plaintiffs. In fact, most of these arrangements contain confidentiality and non-disclosure agreements.\textsuperscript{192} The reality is that a judge will likely never know or be asked to assess the contents of these agreements and will therefore be powerless to safeguard the interests of the individual claimants or to report or reprimand unethical behaviour of the lenders or lawyers.

It is also unlikely in the third-party funding context that the defendant would be able to play the typical adversarial role. Without being privy to the details of the arrangement, they would be unable to scrutinize or vet the funding arrangements. There is some precedent which would suggest that even in situations where a funding arrangement \textit{is} made known to it, a defendant would have little success challenging the status or details of a funding agreement between the plaintiff and its lawyer due to lack of standing.\textsuperscript{193}

\textbf{iv. Reconciling Judicial and Legal Cultures with Litigation Funding}

Despite the many ethical concerns surrounding third-party litigation funding, there are undeniable benefits. The challenge is to find a means whereby we can reconcile our ethical concerns and our desire to preserve a client’s control over her action with the hard commercial realities of the litigation funding industry. Should we simply adjust our commonly held perceptions about the attorney-client relationship when it comes to third-party litigation funding? In some respects, particularly in the class action and mass tort context, the ‘representative’ plaintiffs may at present have a subsidiary role in the initiation, conduct and resolution of proceedings irrespective of the presence of a third party financier. Moreover, it needs to be borne in mind that on the defence side, litigation is often funded and controlled by insurers.

The argument against TPLF due to the client’s diminished control gives rise to a need to distinguish between ownership and control over the claim.\textsuperscript{194} There is a perception that the role of the third party funder is analogous to that of the lawyer in a contingency fee case. However, there are inherent differences in these relationships. The lawyer has clearly defined duties of loyalty to the client and the threat of sanction by professional regulators. Funders have no such duties and answer to no regulatory body.

It has been suggested that the built-in supervisory role played by the courts in class actions could serve to remedy many of the ethical concerns presented by third-party funding arrangements and that the court could potentially act as a “workable monitor” as it

\textsuperscript{192} Burch (n 131) 60 and FN 289. In the Ecuadorian suit against Chevron, all of the details of the funding arrangement were protected by confidentiality clauses.

\textsuperscript{193} Richmond (n 178) 653-654 citing \textit{Killan v. Millard}, 279 Cal Rptr 877, 879 (Cal Ct App 1991). In California, \textit{Killan v. Millard} stands for the proposition that a defendant who is being sued by a plaintiff whose lawsuit is funded by a third-party lacks standing to challenge the associated agreement.

\textsuperscript{194} Steinitz (n 119) 1323.
does in the class certification process. The most obvious obstacle to the application of such a standard of review in third-party finding arrangements is that it would clearly require that the details of the arrangement be disclosed, requiring a distinct shift from the current practice before this model could be instituted. As noted above, there are at present disclosure requirements in Australia that do not appear to have created any problems and, in the Australian context, litigation funding arrangements are often voluntarily disclosed by funders and/or lawyers acting for the funded group. Similarly, Canadian class action judges have interpreted class action statutes, which are very similar to U.S. class action regimes, to grant them approval authority over funding agreements. A move toward approval of class action funding agreements, therefore, would not be surprising in the U.S. context if the market develops in this regard. What form of regulation (if any) may develop for the rest of the TPLF market is far less predictable.

V. Structural Differences and Common Challenges

a. Comparing the Australian, U.S. and Canadian Landscapes

In discussing the merits of TPLF, some lawyers and commentators are quick to look to other jurisdictions, especially Australia, as either cautionary tales or inspired precedent. There are several structural and institutional differences between the jurisdictions, however, that belie a direct application of one country’s experience or practice to another’s. This, of course, is the value of a comparative exercise.

As is apparent in our survey of the three countries’ TPLF practices, there are many differences in the litigation architecture of the jurisdictions. Cost-shifting exists as a rule in both Australia and Canada, while it is the exception in the U.S. Contingency fees are widespread in both the U.S. and Canada, and prohibited in Australia. At least some aspects of the funding agreements are considered to be within the supervisory authority of case management judges in Canada and Australia, whereas they have been treated largely as matters of private contract by American courts, except where they are challenged on the grounds of maintenance and champerty. Laws regarding the latter remain in force in about half of the U.S. states, but have been abolished in most jurisdictions in Australia and interpreted not to apply per se to Canadian funding agreements.

These structural differences have given rise to varying funding practices and degrees of prevalence. As a result of cost-shifting and restrictions on contingency fees, commercial funding in Australia is most active in class proceedings, where plaintiff-side litigants face

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195 Fed R Civ Pro 23. This rule provides the basis for the court’s supervisory powers of the certification process of a class actions; Steinitz (n 119) 1274-75, 1326-1330; Burch (n 131) 37.

196 See e.g. Rossos (n 102), the principal of BridgePoint Financial Services, who states that third party financing “is well advanced in other common law jurisdictions, such as the United Kingdom and Australia, which share our legal culture and traditions and have transformed their legal systems to allow third-party financing” (at 101). See also Eric Armour, “Third-Party Litigation Funding: Is Canada Behind the Times?” The Saskatchewan Advocate (December 2007), online: http://www.lexfund.ca/Portals/0/article7.pdf.

197 The key differences between the three regimes are set out briefly in a table at the end of this paper.
significant financial barriers and funders have significant upside. Funding in such litigation is nascent in both the U.S. and Canada, but appears to be more active in Canada, where the need for indemnities against adverse cost awards has created a market demand for funders that does not exist in the U.S. Funders’ involvement in Australian class actions has given rise to a *de facto* opt-in regime, a phenomenon that has escaped the other two jurisdictions.

Because to date funding agreements in Australia have been negotiated individually with each class member, they are not subject to direct court approval. Canadian courts, on the other hand, perhaps due to the certification requirement (non-existent in Australian class actions) but certainly in light of the judge’s broad authority to make orders for the fair and expeditious conduct of the action, have taken the view that funding agreements must be approved at the outset of the litigation. In the absence of formal practice directions requiring disclosure, as have been introduced in Australia, Canadian judges appear intent on crafting guidelines and rules favouring transparency. Such transparency does not exist in U.S. non-class litigation, but given the similarities between American and Canadian class action regimes, it is likely U.S. class action judges will also require court approval of a funding agreement in a class action.

Concerns about the independence of a lawyer’s advice and representation are entrenched in Canadian and American legal culture. It is not surprising, therefore, that Canadian judges and American commentators have expressed concern about funding arrangements that cede any control of the litigation to commercial funders. More surprising is the willingness with which Australian courts have approved the exercise of a significant amount of control by the funder in the conduct of class actions, commensurate with the funder’s significant financial interest in the case, but not unlike the major role that some commercial insurers play in the financing and the conduct of the defence of claims pursuant to contractual arrangements with the insured party.

Perhaps because of the involvement of the funding non-party, Australian courts have addressed a far greater number of regulatory issues than have been discussed to date in both the U.S. and Canada. Australian courts have determined that TPLF constitutes a managed investment scheme subject to securities legislation, triggering regulatory intervention. No such attention has been evident in Canada, and only a handful of American state legislatures have specifically addressed litigation funding. In the result, any regulation of TPLF in Canada in the near future is most likely to occur by way of judicial attention on a case-by-case basis, while in Australia there is both judicial and regulatory oversight. The U.S. remains essentially an outlier with no federal or concerted state attention to consumer protection and other legal implications of the practice, and virtually no judicial consideration of the practice unless and until TPLF in class actions becomes prevalent.

### b. Common Challenges

#### i. Public Policy

In all three jurisdictions, there is little doubt that commercial funding increases the number of claims that are ultimately litigated. It is the prospect of increased litigation, of course, which draws the most vociferous opposition from TPLF detractors in the U.S. and elsewhere.
At its most extreme, this opposition maintains that TPLF permits plaintiffs and their lawyers to offload all usual litigation risk onto a speculative investor and thus encourages them to test non-meritorious claims. The U.S. Chamber of Commerce has been vocal in its concern that the increase in litigation that was seen in Australia following third party funding of class action in that country could be a side effect of allowing the practice in the U.S. Allowing plaintiffs to shift their costs to third-party lenders encourages the plaintiff’s attorneys to bring claims of questionable merit, knowing that risk-averse defendants will sooner settle than “roll the dice at trial.” In response to the contention that funders are no more interested in risking their money on doubtful actions than is a lawyer working on a contingency fee basis, the U.S. Chamber of Commerce maintains that funders will behave like other speculative investors: if the potential damage award is high, and the higher risk can be spread across a portfolio of cases, then funders will be more willing than lawyers to finance questionable lawsuits.

The specter of unmeritorious cases and litigation blackmail has long been a standard argument against TPLF and against class actions more generally. The experience with TPLF in Australia, however, does not support this claim. While there has been a rise in class action litigation in total numbers since third party funders entered the market, there is no evidence that the cases have been without merit. Moreover, although commercial litigation funding has undoubtedly increased the number of class actions they are still relatively infrequent. The legal experience, expertise and risk aversion of commercial litigation funders in Australia has served to prevent unmeritorious claims rather than facilitate them. In funding cases they usually assume the risk of paying adverse costs if the case is not successful and thus their threshold requirement of litigious merit is very high. Of course, the Australian experience has to be considered in light of the prohibition on lawyers entering into percentage fee arrangements and the prevalence of the ‘loser pays’ rule. What the position would be in jurisdictions such as the United States where the loser pays rule is not generally applicable and contingency fees are robust remains to be seen.

An increase in the volume of litigation is normatively neither good nor bad. More tempered critiques of TPLF accept that ‘risky’ cases are not necessarily without social value. Advocating for a change in the law, for example, when precedent compels a different outcome, can advance public policy, as civil rights litigation and other forms of cause lawyering have shown us. Still, even absent a rise in unmeritorious claims, the commodification of litigation generates other public policy concerns.

First, it is doubtful that commercial funders will be interested in litigation that has significant public interest value if the claims do not attract large monetary damages. In this sense, public funders like the Class Proceedings Fund in Ontario are superior. The commodification of litigation therefore does nothing to increase access to justice for

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198 Selling Lawsuits, Buying Trouble (n 5) 5.

199 Ibid.

200 Lyon (n 135) 591-592.
litigants with human rights, civil rights or other public law-based claims. Second, as the TPLF market expands and matures, a secondary market may develop in which institutional investors bundle and securitize legal claims or sell shares in the funding firm itself.\(^{201}\) In such an environment, the fiduciary duties of the funder to shareholders and partners may irreconcilably conflict with whatever duties are owed to representative plaintiffs, be it by way of contract or judicial interpretation. Managing the agency costs\(^{202}\) of commercial funders’ involvement in litigation, to ensure that they do not distort or strain the justice system, has not been discussed at any length in Canada, and has just begun in the U.S. and Australia.

\[\text{ii. Ethics and Regulation}\]

The most frequent criticism of TPLF is that, if left unregulated, it could result in a runaway market of funders, with little transparency, accountability or protections for the plaintiffs and lawyers who receive the funds. An awareness of the dangers of unregulated third party funding is no doubt essential to its successful implementation in the U.S. and Canadian markets where it is still in its infancy. Opinions on whether this can be ensured through regulation are divided.

Those opposed to government regulation argue that the TPLF market operates well, without harming the public interest or promoting unethical behaviour, because of the inherent risk element of lending.\(^{203}\) After all, litigation funding offers no promise of repayment, little to no collateral to secure the loan, and certainly no guarantee of a profit.\(^{204}\) Lenders have no choice but to be selective in their choice of claim. Where a company’s sole purpose is to fund litigation, presumably its very survival depends upon the outcome of the claims it choses; risk, merit, and potential for favourable outcome must be among the primary concerns for funders. Nevertheless, there is still cause for caution. Funders need to make a profit; so, too, do lawyers operating on a contingency fee (in the U.S. and Canada). Their returns on investment reduce the net recovery to class members, as is evident in the Australian experience. To the extent that access to substantive justice is relevant, then regulation of the amounts charged to clients/class members is necessary.

\(^{201}\) As we have indicated in this paper, several major funders are publicly traded companies. This is one of Steinitz’ principal concerns, even though she ultimately calls for a loosening of the prohibition against TPLF in many U.S. states: Steinitz (n 119) 49.

\(^{202}\) Rubin (n 133) 15. An economist, Paul Rubin argues that “[t]hird party finance of lawsuits seems efficient because it increases the scope for free exchange. However, this appearance of efficiency is illusory as allowing increased sale of lawsuits would create external costs.”

\(^{203}\) McLaughlin (n 150) 621.

\(^{204}\) Ibid. It should be noted that the safeguard provided by the inherent risk to the lender is decreased at the commercial or complex litigation lending level. Here the loans are not nonrecourse but are merely leveraged against the assets of the firm as collateral. The eventual outcome of the action, although a serious consideration for the funder if they intend to profit, does not leave them open to a loss other than in the case of an insolvent client.
Another reason offered in favour of the unregulated, free market model for TPLF is the experience and sophistication of the parties involved, especially at the commercial lending and class action funding levels. This, however, cuts both ways: no regulation also means that there is absolutely no obligation that funders disclose the frequency, amount, or details of their arrangements. This freedom allows many companies to enter into the market undetected and to operate in virtual anonymity, charging what they like as opposed to being bound by an industry standard. Regulations that require disclosure of the details of funding arrangements, particularly with regard to interest rates charged, may serve to lift the monopoly enjoyed by some funders and to allow clients to be more selective when choosing a funder. This would presumably make the market much more competitive while reducing the risk of abuse.

There is some indication that a shift towards this way of thinking is afoot among individual lawyers and law firm lenders: in the U.S. dedicated litigation lenders are making attempts to institutionalize their industry and to improve their image by being more forthcoming about the rates they are charging and to keep those rates closer to credit card interest rates.205 In Australia, the market leader, IMF, has made formal submissions to the New South Wales Law Reform Commission supporting the enactment of regulations that would impose adequate capital requirements, mandatory disclosure of funding agreements at the initial case management conference, and collection and publication of data, including the cost of the litigation to the funders and the parties and the value of the settlements.206 No formal steps toward self-regulation are apparent in Canada.

A strong self-regulatory model has not emerged in the three jurisdictions. In its stead, Canadian courts favour transparency and judicial oversight. In the U.S. ex ante approval of funding agreements in both class actions and individual litigation does not occur, but some have suggested that courts should play this role.207 The remains of a patchwork of state champerty statutes and judicial decisions calling for widely inconsistent levels of disclosure of funding arrangements have achieved little in the way of effective regulation.

Lessons can be gleaned from Australia’s experience. There, recent amendments to Practice Notes in several courts now provide for disclosure of litigation funding arrangement and governments continue to consider the issue of regulatory arrangements. Australia is now grappling with retroactive regulation of an industry that has essentially exploded onto the legal landscape. The Australian Standing Committee of Attorneys-


206 IMF justifies the regulations on the basis that funders, like insurers and the parties, are utilizing a subsidized court system and it is therefore in the public interest to have publicly available information about the ways in which funders and insurers interface with, and impact, the civil justice system. See Submission by IMF (Australia) Ltd., "Security for Costs and Associated Cost Orders" (June 2011), online: http://www.imf.com.au/pdf/Submission%20to%20NSW%20Law%20Reform%20Commission%202011.pdf.

207 Steinitz (n 119) 1274-75, 1326-1330. This is one of the five reforms to TPLF suggested by Steinitz.
General began examining the need for the regulation of third-party funding as early as 2006. Their findings have indicated a need for greater regulation. Although the matter has attracted Commonwealth Government attention there has been little regulatory activity to date, other than to grant exemptions from legislative provisions that have been judicially determined to be applicable, subject to further appellate review by the courts. Although initially proposed that regulations will be aimed at “specifying criteria for legally acceptable funding agreements, and adopting prudential regulation requirements for funders,” this has not occurred to date.

VI. Conclusion

TPLF has been variously described as either a revolutionary alternative funding model that will greatly increase access to courts, lawyers and justice, especially for victims of mass harm, or the next big investment product that will subvert the traditional goals of our justice system. In the absence of judicial attention, burgeoning literature in the U.S., much of it described here, proposes various regulatory responses. Only a few states have taken up that call. In the meantime, the American TPLF market in complex commercial cases has exploded, with little presence in class actions.

In Canada, it is the growing desire to invest in class actions that has triggered judicial oversight of at least some aspects of the TPLF arrangement. The cost-shifting rule in both Canada and Australia accounts for at least part of the market demand for commercial funding in class actions. By virtue of the case management mandated by class action regimes in these two jurisdictions, TPLF has become the inevitable focus of judicial scrutiny. Long-standing principles related to the independence of counsel have informed Canadian courts’ opposition to TPLF contracts that would provide the funder with control of the litigation. The more nuanced argument, that business realities and pressure from the profit-centered funder will result in indirect control, has yet to be addressed.

Australian courts, on the other hand, have addressed the question of control, and a host of other issues, and have determined that the significant investment by funders in litigation as a whole, but especially in class proceedings, justifies shared control. Collateral attacks by defendants have given rise to significant satellite litigation, in which courts have had to consider the application of securities and investment regulatory regimes to this novel product. Governments in turn have had to respond, and in this way, a hybrid model of judicial and legislative oversight is slowly emerging.

The needs of litigants and their lawyers vary in each jurisdiction. The unavailability of contingency fees in Australia has created a distinct market for funders whose investments and contracted rate of return are therefore both high. In Canada and the U.S., different forces drive the TPLF market. In all three countries, however, concerns about the promotion of unnecessary litigation and financial exploitation have, to varying degrees,

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been expressed. Philosophical opposition to commercial funding has been most
pronounced and organized in the U.S., whereas Canadian commentary has been sparse and
focused less on public policy debates, and more on discrete ethical questions.

In this survey of three jurisdictions with rapidly growing TPLF markets, we have
summarized, compared and analyzed current TPLF practices, particularly in class actions,
and the reactions to date by courts and others. As observers in each country ponder how
best to regulate this sector, useful lessons can be gleaned by looking to other jurisdictions
where TPLF is common. As always in any comparative exercise, however, careful attention
must be paid to differences in legal culture, civil justice regimes, and other dynamics.
Whether the TPLF industries in Australia, Canada and the U.S. will ultimately share more
commonalities than differences remains to be seen, as each forges its own unique approach
to the many interesting challenges that justice for profit provokes.
Table 1 – Comparative Chart of Australian, Canadian and American Commercial Funding Regimes

<table>
<thead>
<tr>
<th></th>
<th>Australia</th>
<th>Canada</th>
<th>U.S.</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>1. Nature of Actions Funded</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>a. Class Actions</td>
<td>Yes</td>
<td>Yes</td>
<td>Few</td>
</tr>
<tr>
<td>b. Personal Injury (individual actions or non-class aggregate lit’n)</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td><strong>2. Nature of Funding Agreement</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>a. Contract with Plaintiff</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td></td>
<td>Must also contract with each class member(^{209})</td>
<td>Yes</td>
<td>Most common structure in PI and non-aggregate type litigation</td>
</tr>
<tr>
<td>b. Contract with Plaintiff’s Lawyer</td>
<td>Yes</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Most common in complex, anti-trust, IP, international arbitration, and aggregate type litigation</td>
</tr>
<tr>
<td>c. Indemnity to Rep Plt</td>
<td>Yes</td>
<td>Yes</td>
<td>n/a</td>
</tr>
<tr>
<td><strong>3. Funder Involvement</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>a. May Instigate Class</td>
<td>No(^{210})</td>
<td>No</td>
<td>n/a</td>
</tr>
</tbody>
</table>

\(^{209}\) A test case is presently under consideration to determine whether a funder is able to obtain recovery from class members who have not entered into a litigation funding contract.

\(^{210}\) Not as a party *per se*, but a litigation funder may play an instrumental role in finding suitable plaintiffs and in facilitating the litigation, including choosing class counsel.
<table>
<thead>
<tr>
<th>Action</th>
<th>Australia</th>
<th>Canada</th>
<th>U.S.</th>
</tr>
</thead>
<tbody>
<tr>
<td>b. Degree of Control of Litigation</td>
<td>Considerable</td>
<td>Only entitled to updates re: significant issues; control rests with Plaintiff</td>
<td>Largely unknown due to lack of disclosure</td>
</tr>
<tr>
<td>c. Ability to Exit</td>
<td>Yes, subject to provisions of funding agreement</td>
<td>Only where updates not provided or if Plaintiff changes counsel</td>
<td>Largely unknown—may depend on the terms of the agreement (but none have been disclosed)</td>
</tr>
</tbody>
</table>

4. Court Involvement

| a. Agreement Requires Court Approval | Not if limited to those who enter into contractual agreements[^211] | Yes | No |
| b. Courts Adjudicate Dispute between Funder and Plaintiff | Agreements usually provide for some other means of dispute resolution, including the use of senior counsel | Unknown | Yes After the fact, in a separate action |
| c. Funding Agreement Made Public | In Federal Court proceedings there is a requirement of disclosure to the parties and the court | Not Consistent Practice; some courts approve on ex parte basis | Not Consistent Practice |

5. Regulatory Regime

| a. Two-way Costs | Yes | Yes | No, unless modified by statute |
| b. Security for Costs Required of Funder | Often but not invariably | Sometimes | Unknown |
| c. Prohibition on Fee- | The fee to the | Only with non-lawyers | Yes, generally, but |

[^211]: Although given that any settlement of a class action requires court approval in a number of recent cases judicial attention has focused on the litigation funding arrangement and the amount payable to the litigation funder.
<table>
<thead>
<tr>
<th></th>
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</tr>
</thead>
<tbody>
<tr>
<td>splitting</td>
<td>lawyers and the commission payable to the funder are separate</td>
<td></td>
<td>statutory exceptions have been made</td>
</tr>
<tr>
<td>d. Champertty Rules</td>
<td>Only have limited operation</td>
<td>Yes, but interpreted by courts not to prohibit TPLF contracts <em>per se</em></td>
<td>Yes, but repealed in the TPLF context in at least 29/51 jurisdictions</td>
</tr>
</tbody>
</table>