ACCESS TO JUSTICE: USING THIRD PARTY FINANCING TO FULFILL THE PROMISE OF CLASS ACTION LITIGATION

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A. INTRODUCTION

The evolution of class action litigation has been one of the most dynamic and important developments in Canadian law over the past decade. Invariably the provinces that have introduced class proceedings legislation have sought to accomplish three primary objectives: (i) promote greater access to justice; (ii) ensure the more efficient allocation of judicial resources; and (iii) modify the behaviour of private and/or public institutions by making them accountable to their customers, suppliers, investors, constituents, and anyone else who suffers loss or harm from their wrongful activities.

Class action litigation is very expensive to prosecute; the time period for resolving these disputes may be many years and there are significant risks and uncertainty of outcome. Class counsel is almost universally compensated under a contingency fee arrangement. As a consequence, not only do they provide legal services, they also act as merchant bankers by underwriting the risk of financing the cost of the action. A recent decision by the Ontario Court of Appeal in *Poulin v. Ford Motor Company of Canada Ltd.*[1] also seemed to extend their responsibility to providing an indemnity against adverse cost awards to the representative plaintiff. The reality is that lawyers are not merchant bankers; nor should they be. They do not have the financial resources to adequately invest in legal claims of this scale and complexity. Further, the significant risk exposure that

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1 2007 CarswellOnt 8255 at 10–11 (C.A.) [*Poulin*]..

they assume in doing so may create potential conflicts of interest with the representative plaintiff and class members.

Conversely, class action defendants are generally well capitalized and/or insured; they are sophisticated; they have access to vast resources and highly specialized legal expertise; they are motivated to make the necessary investments to mount a strong and effective defence; and they have the capacity to continue litigation for an extended time period. The tremendous costs of litigation create a funding gap between class action plaintiffs and defendants that arises from the disparity in the economic resources available to each party. This funding gap becomes a significant barrier to achieving access to justice for many Canadians.

Each of the Ontario and Quebec governments introduced a public funding mechanism to try to alleviate the funding gap[2]. However, these organizations do not have the resources nor do they have the mandate to provide financial assistance for all potential class action plaintiffs.

If access to justice is the primary objective of class proceedings legislation, as well as one of the most pressing issues facing the Canadian legal system, then it is time to consider alternative funding models that permit third party financing. This process 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.

This article will:

1. review the promise of class action litigation in Canada as an instrument for providing access to justice;
2. describe the funding gap and how it undermines the fundamental objectives of class action legislation;
3. propose a new model that would allow class action plaintiffs to access third-party financing through the capital markets to address the funding gap; and
4. discuss how it is possible for us to continue to protect the values of our legal system while allowing third-party financing for class action litigation.

2 Class Proceedings Fund in Ontario and Class Action Assistance Fund (Fonds d'aide aux recours collectifs) in Quebec.

B. ACCESS TO JUSTICE: THE PROMISE OF CLASS ACTION LITIGATION

Class action litigation provides a procedural mechanism allowing individual members of society to seek redress for harm or loss suffered from large institutions or organizations whose activities affect the rights and interests of many. To get a better sense of how these actions evolve and why they provide a valuable means of achieving access to justice, it is necessary to describe the fundamental elements of class action litigation.

A "class" is a group of claimants who have been similarly or "commonly" affected by the activities of one or more defendants. The thread that weaves through each of the claimants and binds them as a class is their common exposure to harm caused by the defendant(s) that is recognized in law as a valid legal claim against them. This description over-simplifies the considerations that go into the process of certifying legal actions as class actions but serves the purposes of this article to this point.[3]

In general, a class action defendant directly or indirectly produces goods or provides services that are consumed or used by a large population of people. These organizations may include government institutions or major corporations. Its activities require it to interact with a number of different groups that at any time may include customers, users, suppliers, neighbours, investors, or creditors. These organizations tend to have complex management structures and may operate across diverse geographic areas. They may also have a diverse base of investors or creditors who rely on the timely release of information concerning the financial performance of the organization to make informed investment or credit decisions. This means that if something goes "wrong," there is a high likelihood that a number or "class" of people will be similarly affected and will seek legal redress to compensate for their loss. Considering the size and scale of their operations, these organizations are typically well capitalized and adequately insured to manage commercial risk.

What would happen if there was no mechanism for allowing class actions? Would an individual credit cardholder among a group of 5 million credit cardholders take action against a bank to recover $10 in excess annual charges that were levied in contravention of its service agreement with all credit cardholders? Of 5,000 individuals transplanted with a

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3 The criteria that the courts of Ontario consider in determining whether to certify an action as a class action are set out in *Class Proceedings Act*, S.O. 1992, c.6, s.5.

defective medical device that was known to cause uncertain but potentially debilitating effects on their health and quality of life in the long term, how many would actually commence legal proceedings against the global medical device manufacturer? What if a government agency was grossly negligent in managing a programme that it had created, resulting in significant losses and bankruptcy for thousands of small businesses within a particular industry? How many of these failing businesses would be in a position to seek appropriate compensation against the government?

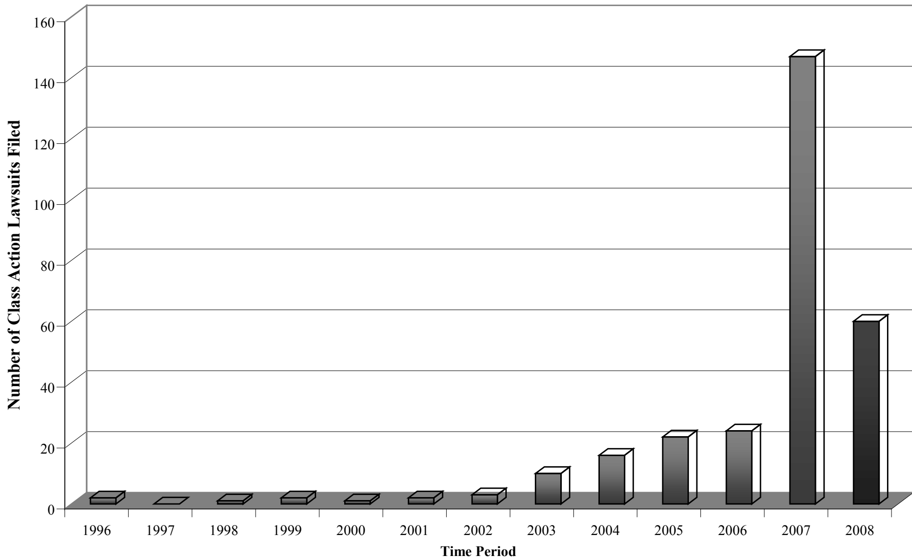
In each of these examples there are a number of individuals who form part of a larger identifiable group, or class, with similar legal claims against the defendant where there is a strong likelihood that many would not be in a position to effectively prosecute their legal claim on their own. They would be denied access to justice. Those who decide to litigate would force the defendant to defend a multitude of actions all dealing with common or similar issues. Although the defendants may be disadvantaged by having to defend multiple actions they may view this as a mere cost of doing business. However, the prosecution of these actions individually would impose a heavy cost on the administration of justice by diverting significant judicial resources away from other worthy claims and contributing to further backlog and delay.[4]

In the first example the bank is generating an additional $50 million in profit annually and defending a series of actions against individuals with limited financial resources may be well worth the cost. Similar considerations may apply to the medical device manufacturer that saved millions of dollars in research and development costs and was willing to assume some risk in bringing an innovative new product to market before its competitors to gain first-mover advantage. One can persuasively argue that government and government agencies in a representative democracy have a higher moral and ethical duty to their constituents than commercial organizations do to their customers, suppliers, investors, creditors, etc. Nevertheless, there are examples where government or government agencies invariably weighed the social, economic, or political benefits of an action (or inaction) against the risk of harm to others and chose to assume the risk.

Class proceedings legislation was introduced in most jurisdictions across Canada to address these issues. Consequently, the evolution of

4 The idea of using mass tort actions to prosecute smaller populations of claims in substitution of, or in coordination with, class proceedings will be reserved for future discussion.

class action litigation has been one of the most dynamic and important developments in Canadian law over the past decade. The following chart illustrates the growth in class action litigation in Canada since 1996.[5]



Despite the dramatic increase in class action litigation in Canada, particularly over the past two years, there is some concern that the current system is not working as well as it should or could. The exceptional spike in class action filings over the past eighteen months will require a significant infusion of capital within the legal system over the course of the next few years as investments will be required to prosecute these actions. The funding issue, which will be discussed in more detail in the next section, will become more acute over time if this trend continues.

Although there are differences in class proceedings legislation among the provinces, they share three primary objectives:

5 Based on information compiled from the Canadian Bar Association's National Class Action Database for the period beginning March 1996 and ending June 2008.

1. promoting access to justice by providing a mechanism for compensating claimants who otherwise may not be position to individually litigate their claims;
2. ensuring that such proceedings promote judicial economy by avoiding multiple actions involving similar claims advanced against the same party(ies); and
3. holding offending organizations accountable for their actions and compelling them to modify their behaviour accordingly.

Promoting access to justice is the most important of these objectives. The legitimacy of our legal system as the guardian of individual rights depends on ensuring that all people with legitimate claims have access to courts seized with the authority and expertise to adjudicate those claims and enforce rights. The objective of promoting access to justice through class actions is clear. The more important question is: has it fulfilled its promise?

C. THE FUNDING GAP

Although class action lawsuits are typically initiated by an individual or a small group of individuals acting as representative plaintiffs, the responsibility for financing the cost of litigation is borne by their counsel — plaintiff class action law firms. In Canada, the class action bar is still in an early stage of evolution. Considering the relatively small size of the Canadian economy and the high degree of corporate concentration relative to other developed countries, it is difficult for class action firms to develop a balanced book of plaintiff and defence work. Consequently, law firms will generally provide legal representation for either class action plaintiffs or defendants. This is obviously a generalization and does not dismiss the possibility that a law firm will provide services to both sides where there is no conflict.

There is a sharp distinction in the retainer arrangements and, consequently, business models employed by plaintiff and defence firms specializing in class action litigation. Class action defendants have the resources to pay for the cost of legal fees and expenses on a timely and continuing basis for however long the action continues. Because class action defence counsel does not bear the risk of financing their cases, they are able to simply focus on what they have been trained to do — practice law.

Conversely, the retainer arrangements between plaintiff class action counsel and the representative plaintiff(s) are remarkably different. Class counsel will enter into a contingency fee agreement with the representative plaintiff that will require it to be responsible for paying the full cost of disbursements and financing the cost of their legal fees for an indeterminate time period until the action is finally resolved in exchange for receiving compensation equal to a fixed percentage of the total amount recovered by the class. Class counsel fees must be approved by the court. This means that counsel is not only responsible for providing legal services for their clients; they become merchant bankers underwriting the significant risk for financing the cost of the action. A recent decision by the Ontario Court of Appeal in *Poulin v. Ford Motor Company of Canada Ltd.*[6] also seemed to extend their responsibility to providing an indemnity against adverse cost awards to the representative plaintiff.

Is it appropriate for class counsel to assume full responsibility for financing the cost of class action litigation and the substantial risk of loss in the event the action is unsuccessful? Since contingency fee arrangements have become the norm in certain areas of litigation, namely personal injury litigation, is it possible to distinguish between the utility of contingency fee arrangements in non-class action versus class action litigation?

For non-class action litigation, one can argue that contingency fee arrangements promote access to justice. Many individuals who otherwise could not afford to pay for the cost of legal services would not be in a position to assert their legal rights and obtain justice in a court of law. Through contingency fee arrangements clients are willing to provide counsel with an "equity" or ownership interest in the underlying economic value of their legal claim in exchange for assuming the risk of financing their action. One could argue that this perfectly aligns the interests of counsel and their client. It is a commonly held belief that this is a win-win situation. A lawyer is motivated to maximize the value of their clients' legal claims because by doing so they are also maximizing their return on investment.

Contingency fee-retainer arrangements generally require lawyers to finance the cost of disbursements and legal fees and bear the risk of loss if the case is unsuccessful. Lawyers will enter into these arrangements so long as they are appropriately compensated for accepting this risk. In more traditional areas of litigation, such as personal injury, lawyers have

6 *Poulin*, above note 1 at 10–11.

demonstrated a strong capability for being able to assess and contain risk. Relative to class actions, personal injury actions are generally less complex which makes it easier for experienced counsel to assess and quantify the value of a client's legal claim. Lawyers can generally determine with a reasonably high degree of certainty how much money they will be required to invest in disbursements for a particular file; and they can also reasonably predict the time period for resolving these claims. Most importantly, they can diversify their risk by investing relatively smaller amounts of money across a larger population of files. If they are prudent assessors of risk they will generate economic returns that adequately compensate them for their risk for the vast majority of files and suffer losses infrequently.

One can argue class counsel assumes substantially higher risks. On average, class actions are more capital intensive than non-class actions. Class counsel has the responsibility of provÿÿÿÿa person's legal claim and extenÿÿle tÿÿ defendant(sldliability to a broader population of people. They must also go through an initial procedural step of certifying the action as a class action. This adds a higher degree of complexity to prosecuting these actions. As a consequence, significant investments in time and money are required to fight procedural battles (especially where the litigation is conducted simultaneously in a number of different jurisdictions); hire qualified experts to deal with more complex issues concerning causation and/or an assessment of damages for a population of potential claimants; undertake extensive legal research in a rapidly evolving area of law; and establish a marketing and/or communications strategy to organize a definable class of clients and manage those relationships on an ongoing basis.

By investing more money in class action litigation, counsel assumes a higher degree of risk than for non-class action litigation. However, there are other elements of the class action process that further amplify this risk over and above the required financial investment. Class counsel is dealing with a rapidly evolving area of the law where there is not yet an established body of jurisprudence providing a comparable level of structure and predictability that exists in other areas of the law. Counsel must also deal with exogenous variables beyond its control that may have a material adverse effect on the economic value of its case. For instance, where class proceedings are multi-jurisdictional, there is a risk that class counsel in another jurisdiction may decide to minimize its investment and settle at less than fair value, compromising the economic value of the action in other jurisdictions. The longer time period for resolving class

action lawsuits creates greater uncertainty for class counsel by consuming cash and access to credit, and imposing significant opportunity costs. Class counsel also does not have the ability to both limit its financial investment and diversify risk across a large population of files. Although contingency fee arrangements offer a valuable mechanism for providing individuals with access to justice in non-class action proceedings, in class action proceedings these arrangements may potentially increase the potential for conflicts of interest between class counsel and the representative plaintiff, where counsel's risk of gain and/or loss is disproportional to that of the representative plaintiff.

Notwithstanding the potential conflicts between class counsel and the representative plaintiff, there is a significant imbalance between the economic resources and financial expertise available to a defendant multinational corporation or government institution and those available to the representative plaintiff(s) and class counsel. This disparity in economic resources (funding gap) undermines the primary objective of class action litigation — promoting access to justice. If this is a value worth preserving, we must find ways to close the funding gap.

D. TOWARDS A NEW MODEL — THE ROLE OF THIRD PARTY FINANCING

In Ontario, the legislature recognized that the legitimacy of a class action regime depended on providing individuals with access to justice. As discussed above, the cost of class action litigation creates a funding gap realized by the disparity between the economic resources available to the representative plaintiff and the defendant respectively. To address this issue, the legislature created the Class Proceedings Fund in 1992 with an initial endowment of $300,000 from the Law Foundation of Ontario.[7] The Class Proceedings Fund provides representative plaintiffs with a source of financing to cover the cost of disbursements, along with an indemnity for costs in the event the representative plaintiff's action is unsuccessful.

Representative plaintiffs must submit an application to the Class Proceedings Committee to receive funding. In determining whether to approve an application for funding the Class Proceedings Committee considers:

1. the merits of the plaintiff's case;

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7 *Law Society Act*, R.S.O. 1990 c. L.8, s. 59.1(1)(b).

2. whether the plaintiff has made *reasonable efforts to raise funds from other sources*;
3. whether the plaintiff has a clear and reasonable proposal for the use of any funds awarded;
4. whether the plaintiff has appropriate financial controls in place to ensure that any funds awarded are spent for the purposes of the award; and
5. any other matter that the Committee considers relevant.[8]

It is noteworthy that the criteria for approving funding applications includes the provision that a representative plaintiff demonstrate that "[it] has *made reasonable efforts to raise funds from other sources*." The term "other sources" is not restricted to class counsel and implies a much broader class of potential investor. The Class Proceedings Fund was not created to provide financial assistance for all potential class action lawsuits. Since its inception in 1992, the Class Proceedings Fund has approved twenty-nine applications for funding and has awarded a total of $1,520,834 in financing. This represents an average investment of $52,442.55 per successful applicant.[9] Unfortunately, the cost of prosecuting class actions may involve investments in disbursements that are a multiple of this figure. Further, the Class Proceedings Fund does not provide financing for legal fees.[10] Consequently, many law firms may not have sufficient access to working capital to make appropriate and timely investments in the action. Restricted access to capital may significantly compromise class counsel's ability to maximize the recovery for the class. Finally, as a creature of the Law Foundation of Ontario, it is generally understood that the Class Proceedings Fund will operate with a view to advancing legal claims that serve the public interest. This is as it should be. It was not designed to finance all potential claims.

Access to justice is best achieved by allowing third parties to finance class action litigation. This is the only solution that adequately addresses the funding gap issue. During the course of history, the capital markets have played a critical role financing activities that have led to profound technological, commercial, and social innovation and change. The capital

8 *Law Society Act*, R.S.O. 1990 c. L.8, s. 59.3(4) [Emphasis added].

9 Class Proceedings Committee, "Semi-Annual Report on Class Proceedings as at December 31st, 2007," 5th Annual Symposium on Class Actions, Osgood Hall Law School, 10 –11 April 2008, Tab 3-b.

10 *Law Society Act*, above note 8, s.59.3(2).

markets provide an efficient mechanism for allocating risk to parties who are best positioned to accept it at the lowest available price. There is no reason to deny those who seek access to justice from these benefits.

Allowing private sources of capital to invest or finance legal claims remains a controversial issue within the Canadian legal community. These concerns are best summarized in a Report to Convocation by the Professional Regulation Committee of the Law Society of Upper Canada titled *Review of Rules Related to the Financing of Law Firms*.[11] In this report, the committee expressed concern that third-party financing may be detrimental to the core values of the profession and opted to recommend the *status quo*.

Similar debates have taken place in other common-law jurisdictions that share common traditions and values with the Canadian legal system. In the U.K., Sir David Clementi authored a report in December 2004 titled *Review of the Regulatory Framework for Legal Services for England and Wales*.[12] This report served as the foundation for the significant, some might say revolutionary, changes being introduced to both the legal profession and the way legal services are offered in the U.K. with the introduction of the *Legal Services Act*.[13] It is also noteworthy that Clementi's conclusions supporting the liberalization of third-party investment in legal practices differ from those of the Law Society of Upper Canada. Clementi advocates a system of regulation that would protect the core values of the legal profession by insulating them from the potential interference of third-party investors:

> It should not be permissible for the owner [investor], under the terms of the LDP's [Legal Disciplinary Practice] regulatory conditions, to interfere in any client case or to have access to any individual client files or client information. What the owner does have a right to seek, from the money he invests in the business, is a proper profit. But then lawyers are not uninterested in such matters either. The notion that for lawyers, unlike businessmen, making money is a merely happy by-product of doing their professional duty has limited resonance with the public.[14]

11 Law Society of Upper Canada, Professional Regulation Committee Report to Convocation, *Review of Rules Related To the Financing of Law Firms* (27 January 2005) at 18–32 [*Review of Rules Related To the Financing of Law Firms*].

12 U.K., Department for Constitutional Affairs, *Review Of The Regulatory Framework For Legal Services In England And Wales –Final Report*, by Sir David Clementi (London: Dept. of Constitutional Affairs, 2004) [Clementi].

13 *Legal Services Act* (U.K.), 2007, c.29.

14 Clementi, above note 12 at 121–22.

With the ratification of the *Legal Services Act*, law firms in the U.K. will be able to access third-party financing by 2011.

Relative to the largest and most economically developed common-law countries (Canada, the U.K., and the U.S.), Australia appears to be at the forefront of the debate concerning third-party litigation financing. The legal system in Australia has experienced a profound liberalization in the rules governing the financing of law firms and legal claims. These rules have been enacted to redress the funding gap and facilitate greater access to justice for the general public.

While U.K.-based law firms are currently evaluating the implications of allowing third-party investment in legal practices as 2011 approaches, Australian firms are adapting to a more dynamic regulatory environment that already allows this. On 21 May 2007, Slater & Gordon, a personal injury law firm based in Melbourne sold 35 million common shares to the public, representing an ownership position of approximately 35 percent. The common shares are listed on the Australian Stock Exchange, and the firm is now subject to the obligation of continuously disclosing its financial information and any material change in its business or prospects going forward. By accessing the capital markets, Slater & Gordon is able to diversify its investor base, lower its cost of capital, and make the necessary investments required to improve the quality of legal services that it offers its clients. These financial resources enable the firm to properly invest in client files by hiring the highest quality experts, attracting highly qualified lawyers, and improving the overall quality of its legal research, training, and internal systems and processes. Similar to other industries, law firms that have greater access to capital will have a competitive advantage over law firms that do not have access to comparable levels of funding. The capital markets are competitive. Longer-term, capital will flow to those firms that provide the highest quality of service at the most competitive prices. These benefits ultimately accrue to the final consumer — a person with a legal claim who needs a good lawyer.

In Australia, the courts have recognized that the benefit of third-party financing should also extend to class or representative actions. In a recent decision by the High Court of Australia, *Campbells Cash and Carry Pty Ltd. v. Fostif Pty Limited*,[15] the social policy objectives of improving access to justice by allowing third-party litigation financing were measured against the potential risk of abuse of process. In *Fostif*, a class action was

15 [2006] H.C.A. 41; (2006) 229 ALR 58; (2006) 80 A.L.J.R. 1441 (30 August 2006) [*Fostif*].

brought by a number of tobacco retailers against licensed wholesalers who incorporated into the price of tobacco products license fees that were deemed invalid by the High Court of Australia in *Ha v. New South Wales*.[16] The retailers sought to obtain a refund for the amounts paid to the wholesalers as license fees that were not remitted to the taxing authority by the date of the High Court's decision in *Ha*.

There were a number of reasons why this case was so unique. The action was financed by Firmstones Pty Ltd. Firmstones was a firm of chartered accountants that provided tax consulting services to Australian businesses, including a number of tobacco retailers. Firmstones recognized that many of these retailers had a claim for licence fees that were improperly retained by wholesalers of tobacco products and encouraged the retailers to recover these fees. It actively organized and solicited support from tobacco retailers to have the authority to act on their behalf to recover the improperly paid fees. As payment for its services Firmstones requested a one-third interest on all amounts recovered and also proposed to bear the risk of paying all costs in the event the retailers' claims were unsuccessful. Firmstones retained counsel that acted under its instructions as principal and not as agent on behalf of the class. It actively managed the litigation by initiating and settling a number of individual actions against the wholesalers. However, considering the number of retailers with unresolved claims and the danger of losing these claims with the expiry of the limitation period, Firmstones subsequently launched a series of class actions on behalf of retailers who had not initiated a legal claim. The *Fostif* action was a class action that was largely treated as a reference case by the High Court of Australia.

Although the High Court addressed a number of different legal issues in assessing the merits of the plaintiffs' claims, two central issues were whether the existence of the financing arrangement itself and the nature of Firmstones' involvement in creating and managing the litigation, were a violation of public policy and an abuse of process. The trial judge held that the financing arrangements were an abuse of process. This decision was reversed on appeal. The majority of the High Court upheld the Court of Appeal's decision that the funding arrangements and Firmstone's role and participation in the litigation did not violate public policy nor were they an abuse of process. The High Court spent considerable time weighing the social policy objectives of representative class actions as an instrument promoting greater access to justice against the historical restrictions

16 [1997] H.C.A. 34; (1997) 189 CLR 465 [*Ha*].

imposed by the laws of maintenance and champerty. In particular, Mr. Justice Kirby observed:

> In considering accusations that the funding arrangements introduced by Firmstones into the present proceedings amounted to an abuse of process it is necessary to keep in mind the particular demands inherent in representative proceedings; the need to marshal effectively substantial resources; to gather voluminous evidence; to retain and pay competent counsel over a significant period; often to provide in advance substantial security for costs; to attend both to the general issues and to those particular to identical subcategories and individual cases; and to prove consequential losses with the evidence of several experts. In proceedings such as the present, faced with such daunting requirements, the ordinary tobacco retailer would commonly give up. If the only way to vindicate legal rights was to bring individual proceedings or to find others with exactly the same interest, most ordinary retailers would abandon hope. They would not enforce legal rights or action belonging to them, existing in theory or by analogy with the decision of this court in *Roxborough*. They would withdraw rather than venture upon such expensive, stressful, perilous litigation. They would do this despite the earlier recovery by retailers of the unremitted taxes disgorged in circumstances apparently indistinguishable from their own. Individually, for most or all of them, enforcement of legal rights would not be worth the cost, risk and effort.[17]

He then went on to support the funding arrangements:

> The reason why it is difficult to secure relief of such a kind is explained by a mixture of historical factors concerning the role of the courts; constitutional considerations concerning the duty of the courts to decide cases that people bring to them; and reasons grounded in what we would now recognise as the fundamental human right to have equal access to independent courts and tribunals. These institutions should be enabled to uphold legal rights without undue impediment and without rejecting those [third party investors] who make such access a reality where it would be a mere pipe dream or purely theoretical.[18]

17 [2006] H.C.A. 41 at 33–34, online: www.austlii.edu.au/au/cases/cth/HCA/2006/41.html.

18 [2006] H.C.A. 41 at 35, online: www.austlii.edu.au/au/cases/cth/HCA/2006/41.html.

The High Court's decision should also be considered within the context of the passage of the the *Abolition Act*,[19] which abolished maintenance and champerty as a crime and an action in tort in New South Wales. However, section 6 of the *Abolition Act* does not affect any rule of law in which a contract is to be treated as contrary to public policy or illegal. Although the court made reference to the *Abolition Act,* it did not rely on it as being determinative of the issue.

It may be tempting to argue that the High Court's finding in *Fostif* on the issue of public policy and abuse of process was influenced by the legislative intent expressed by the ratification of the *Abolition Act*. However, this interpretation may be too narrow. A better position may be to consider independently the passage of the *Abolition Act* and the High Court's decision in *Fostif* as significant inflection points in the continued evolution of the Australian legal system. The legislature and the courts appear to recognize that with the appropriate controls in place, third party financing can be used to strengthen the legal system by providing legal claimants with the financial resources to redress the funding gap. Nowhere is this inequality more pronounced than in the prosecution of class actions. By allowing private investors to finance legal claims, we can satisfy the primary objective of the class action regime: ensuring access to justice for all members of society irrespective of their economic position or standing.

The High Court's decision in *Fostif* presented a compelling analysis of the issues that balance the values of facilitating greater access to justice versus the concern that liberalizing funding arrangements will increase the potential for the abuse of process. The problematic feature of *Fostif* is Firmstone's role in *creating*, *organizing*, and *managing* the litigation over and above its role as financier. It could be argued that without Firmstone's initiative the tobacco wholesalers would have profited at the expense of the tobacco retailers, and therefore its actions are justified since it righted a wrong. On the other hand, if these activities are left unchecked there is tremendous potential for third-party investors to attempt to manufacture legal claims for profit, which would undermine the integrity of the legal system. We must find the right balance to ensure that the core values of our legal system are protected.

19 *Maintenance, Champerty, and Barratry Abolition Act 1993* (NSW) [*Abolition Act*].

E. PROTECTING THE VALUES OF OUR LEGAL SYSTEM

It is time for Canadian lawyers, judges, and legislators to fundamentally re-evaluate the role of private investment as a way of facilitating greater access to justice for all. These issues are not unique to the Canadian legal system. Our legal system predated Confederation and evolved from the system established by imperial decree from what is now the U.K. In many ways our legal system has more in common with the values and traditions of the U.K. and other commonwealth countries, such as Australia, than we have with the United States, a country with whom we are much more closely integrated economically. Yet both the U.K. and Australia have undertaken very significant reforms to open their respective legal systems to third-party financing. These reforms have been made to improve the access and quality of legal services offered to the general public.

As discussed, in 2005 the Law Society of Upper Canada explored the issue of alternative financing models for law firms and decided to recommend the *status quo*. It is time for them to reconsider their position. More specifically, there is a greater sense of urgency in addressing the tremendous funding gap that is inherent in class action litigation. Private investment can play an important role in facilitating greater access to justice for claimants by:

1. providing the financial resources needed to pay for the high costs of litigating these claims over an extended period of time;

2. transferring the risk of an adverse cost award from representative plaintiffs to a more diversified pool of investors who are better able to absorb the risk of loss;

3. eliminating potential conflicts of interest between class counsel and the representative plaintiff and class members where there is the possibility of a disproportionate distribution of gains or losses between them with the success or failure of the action;

4. allowing class counsel access to the financial resources necessary to seek and retain the highest quality people with expertise in finance, technology, industry, or strategy to assist class counsel and the representative plaintiff in maximizing recovery for the class;

5. creating a flexible range of solutions that best meets the needs of the representative plaintiff and class counsel (not a "one size fits all approach"); and
6. reducing the overall cost of capital to the representative plaintiff and class members over time as the market matures; investors gain the experience to more accurately assess risk, and new players enter.

Notwithstanding the benefits of liberalizing third-party financing arrangements for class actions, it is critical that any reforms are structured to preserve the integrity of the legal system and the core values that form the heart of it. It is worth repeating the three core values of the legal system that were identified in the aforementioned Law Society of Upper Canada report:

1. Maintaining independence;
2. Protecting client confidentiality; and
3. Avoiding conflicts of interest.[20]

It is possible to structure third-party financing arrangements that meet these basic objectives.

1. Maintaining Independence

The solicitor-client relationship is one of the few privileged relationships recognized in law. Counsel is obligated to exercise independent judgment free from any influence and faithfully advance the interests of their client. Although counsel may consider input from third-party investors concerning any matters relating to the litigation, they must abide by their client's instructions.

In Canada, the courts actively supervise class action litigation, which further protects the interests of the representative plaintiff and class members. The courts approve any agreement that purports to bind the class, determine whether the action should be certified as a class action, evaluate and approve the terms of settlement, and, where there is no settlement, judge the merits of the action. The court will also ultimately approve class counsel's legal fees. To protect the interests of the representative plaintiff and class members, the legal system imposes significant responsibilities on class counsel and ensures that the courts have stringent oversight over

20 *Review of the Rules Related to the Financing of Law Firms*, above note 11 at 19.

class proceedings. Accordingly, it is inconceivable that third-party financing arrangements could compromise the independence of counsel and threaten the interests of the representative plaintiff.

Sophisticated investors will understand these obligations and will structure their arrangements accordingly. The most important consideration for financing a class action is the quality of legal counsel. The value of a legal claim is a direct function of class counsel's skill, experience, and judgment in managing it. Prudent investors will not substitute their judgement for that of class counsel. They will recognize that the rules governing the independence of counsel will prevent them from taking active control over the management of a legal claim. They understand that they will not be able to replace class counsel if they disagree with them or if their interest otherwise diverges from that of the representative plaintiff and class members. Although these limitations create a higher degree of risk, investors will weigh these risks against the expected economic return for financing the litigation and will negotiate terms that meet their investment criteria. In effect, maintaining the independence of counsel requires an investor to make a passive investment in the litigation. This is not a new concept within the capital markets. Appropriate provisions can be incorporated by contract into the financing agreement between the parties, enshrining both the independence of counsel and restrictions on the decision-making authority of the investor.

2. Protecting Confidentiality

While the principle of maintaining the independence of counsel may create a potential conflict of interest with investors, the requirement to preserve the confidentiality of information concerning litigation, and, by extension, protecting solicitor-client privilege, does not lead to any such conflict. Solicitor-client privilege is sanctified in Canadian law as providing fundamental protection to litigants, enabling them to seek unfettered access to legal advice. The value of a legal claim may be compromised where confidence is violated, or the protection afforded by privilege is threatened. It is not in an investor's interest to do anything that would harm the representative plaintiff. In this regard, there is a true alignment of interest between the investor, representative plaintiff, and class counsel. Accordingly, allowing third-party financing for class action litigation will not threaten the principle of protecting confidentiality. Nevertheless, stringent provisions protecting confidentiality and privilege may be incorporated into financing agreements that would establish significant penalties for breach.

3. Avoiding Conflicts of Interest

Because third-party investors would not be in a position to manage or influence the final resolution of a class action they are less exposed to conflict, albeit more vulnerable to bad decisions made by the other parties. However, by its nature class action litigation introduces opportunities for potential conflicts of interest to arise between the representative plaintiff and class counsel. For instance, in "cost" jurisdictions, such as Ontario, the aforementioned decision in *Poulin* suggests that class counsel has an obligation to provide representative plaintiffs with an indemnity against adverse cost awards. Although there may be access-to-justice arguments favouring the grant of indemnities to representative plaintiffs by class counsel, the counter-argument is that such indemnities increase the potential for a conflict of interest between the parties. It is always open to the representative plaintiff to claim that counsel did not fearlessly prosecute the action and recommended settlement for fear of being exposed to the risk of loss flowing from the indemnity.

If the indemnity was provided by a third party there would be no conflict between class counsel and the representative plaintiff. It would facilitate greater access to justice by protecting the representative plaintiff against the risk of an adverse cost award and ensure a truer alignment of interest with class counsel.

Indemnities are not the only source of potential conflict between the representative plaintiff and class counsel. Class proceedings introduce a different type of lawyer-client relationship. At different stages of the class action either party, the representative plaintiff or class counsel, may have a disproportionate interest in the benefits of the action or the risk of loss relative to the other. For example, in the later stages of the class action, where class counsel has invested significant amounts of money over an extended period of time, it will be motivated to try to lower its risk exposure. Irrespective of its professional obligations, at some point there may be pressure to lower the risk threshold and reduce uncertainty by settling the action (i.e., recommending settlement). Of course its assessment of risk will always be measured against its expected financial return. This becomes problematic when the representative plaintiff does not have the same level of risk exposure and has different or potentially unrealistic expectations concerning the value of the claim.

To revisit the indemnity issue, the representative plaintiff in a cost jurisdiction such as Ontario, may face a higher degree of risk at the certification stage. Up to this point class counsel may not have made major

investments in the action and bears minimal financial risk; yet, if the certification motion is successful class counsel may be in a position to generate significant financial rewards. At this particular moment in time, class counsel's potential rewards are disproportionate to its risk. However, the story is different for the representative plaintiff. If the certification motion is unsuccessful the representative plaintiff will bear a significant loss; yet, if the certification motion (and ultimately the action) is successful the representative plaintiff's share of the potential monetary award may not be significant, either in absolute dollar terms or relative to the total recovery by the class. In hindsight it may have taken significant risks on behalf of class counsel and class members that were disproportionate to the benefit it obtained. The problem is that a representative plaintiff may not fully appreciate or understand the risk-reward dynamics of its position. This analysis was likely behind the court's reasoning in *Poulin* where class counsel was held accountable for protecting the interests of the representative plaintiff.

These scenarios highlight how serious conflicts of interest may arise due to the asymmetrical distribution of risk between the representative plaintiff and class counsel. This distribution is not static and will shift over the course of the class proceeding. Ironically, third-party investors may be able to minimize conflicts between class counsel and the representative plaintiff. Third-party financing arrangements will remove class counsel from the financial pressures that may motivate them to minimize their investment in the action and/or prematurely settle. Investors with 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. Since third-party investors will not be in a position to control the litigation, they will be highly motivated to provide whatever assistance they can to maximize the value of recovery for all class members and resolve any potential conflicts.

F. CONCLUSION

Allowing private investors to finance class action litigation will facilitate greater access to justice for all potential claimants. Class action litigation is capital intensive, the legal issues are highly complex, the resolution of the action may take many years, and the law continues to rapidly evolve. These factors collectively introduce significant risk and uncertainty for class action litigants. However, a defendant, whether a government orga-

nization or a major corporation, has the resources to finance the cost of litigation for as long as it takes while also being able to manage the risks and uncertainty of an adverse outcome.

The representative plaintiff and class counsel do not have access to the same level of resources. Currently, the only sources of financing available to the representative plaintiff are provided by class counsel through contingency fee agreements and publicly funded entities such as the Class Proceedings Fund. Class action lawyers are trained to provide legal services. They are not merchant bankers; nor should they be.. They potentially place themselves in a conflict of interest when they provide indemnities to the representative plaintiff and bear a high degree of risk financing significant claims with limited resources. The Class Proceedings Fund does not have the mandate or the resources to finance all potential class action claims.

The funding gap between the plaintiff and the defendant in a class action creates a strong disincentive for individuals to seek access to the legal system to protect or enforce their legal rights. The solution is to allow third-party investors to finance class action litigation. The recent trend of class action filings presented earlier in this article highlight an acute need for a greater infusion of capital to finance these claims in the future. In the absence of third-party financing, the funding gap will widen further. In developed economies, the capital markets have played a critical role in financing innovation and the development of new industries, industrial processes, and technologies by spreading the risk of loss among investors who are willing to accept those risks for an appropriate return. The same benefit should be extended to people who have suffered significant losses and do not have the necessary resources to pursue their legal rights.

Although there are legitimate concerns that third-party investors may potentially compromise the values and integrity of the Canadian legal system, there are ways of ensuring that the core values of our system: the independence of counsel, client confidentiality and the preservation of solicitor-client privilege, and avoiding conflicts of interest are incorporated and protected in financing agreements. Other jurisdictions such as the U.K. and Australia have weighed these same considerations and have recognized the need to improve the quality and access of their legal systems by allowing third-party investors to finance the cost of litigation. We need to revisit these issues with a fresh perspective. The promise of class action legislation was to promote greater access to justice. The cost of access is high; the cost of failure is unimaginable.