LITIGATION FUNDING IN NEW ZEALAND

INSURANCE LAW CONFERENCE 2020

Introduction

1. Everything that could be possibly said(and more) has been written and spoken about the subject of litigation funding in recent years. The arguments for and against have been debated exhaustively. What can be said, without fear of contradiction, is that the battle has been won. Litigation funding is here to stay.

2. It is worth reflecting briefly on what has brought this situation about, on the extraordinary changes in the legal landscape that have spawned the sudden emergence of litigation funding. When I started in legal practice 50 years ago the legal profession and the nature of civil litigation before the Courts was relatively simple, reflecting a much less complex society. Contractual disputes were largely restricted to land sales, day to day commercial transactions (hire purchase agreements were a favoured subject), and producer or supplier agreements. The government's principal area of litigation was in tax disputes, with very little by way of commercial activity.

3. Insurers faced little litigation exposure by way of public liability indemnity claims and subrogated claims for recovery were rare. Their only significant participation was as indemnifiers of employers facing common law claims for personal injuries. These claims were by volume and amounts the largest to occupy the Courts resources in the area of tort law. When they were rightly abolished in 1974 fears were expressed for the future financial health and wellbeing of the legal profession.

4. Fortunately (or unfortunately perhaps, depending on personal perspectives) the legal profession is collectively resourceful. The subsequent growth in litigation has been on a scale never foreseen 50 years ago. The focus has been on the expansion of non- contractual duties owed by a range of corporate and governmental bodies as the scope and scale of their activities has progressively widened to cope with the demands of a changing, more complex, society.

5. Novel duties of care have been recognised and enforced across a wide spectrum of activity. For example, solicitors negligence claims were a rarity until the early 1980s. Local authorities were relatively immune from attack until then also. Some inroads were made, however, into their exposure in the mid 1970s. But the doors were flung open by the landmark decision in *Hamlin*[1]. Gradually our appellate courts widened the net of exposure in keeping with relevant jurisprudential developments elsewhere.

6. There were also major developments in commercial and associated fiduciary obligations. The Court of Appeal's decision in *Coleman v Myers*[2] opened the door to liability of shareholders and directors based on the existence of fiduciary obligations in commercial transactions. The 1994 decision of the High Court in the successful claim for damages of over $300 million by the liquidators of the *Equiticorp* Group against the NZ Government, after a trial of many months duration, was another step. The economic reforms of the 1980s created a raft of state owned enterprises which became extensively involved in commercial activity. There was also a raft of consumer protection legislation, principally the Fair Trading Act 1986, which opened new rights of recourse.

7. With these changes came others. Institutions (commercial and governmental), professional bodies and individuals sought indemnity against their exposures. The insurance industry responded through increasingly complex liability policies. The market has responded to these new areas of business but the costs are high.

8. Over the same period the legal profession has evolved from a static to a dynamic body embracing commercial and technological changes. Its structures have become more business orientated, and legal fees have increased accordingly. The cost of legal services has gradually become prohibitive for ordinary citizens, exemplified by the intrusion of a Chicago based funder into the acquisition of unsettled claims by owners of homes damaged in the Christchurch earthquake. Arguably the fact that those owners were unable to afford the expense, financial and emotional, of continuing litigation against appropriately resourced insurers and instead sought discounted recourse by selling their rights to an unrelated

[1] *Hamlin v Invercargill City Council* [1994] 3 NZLR 513 (CA) , affirmed [1996 1 NZLR 513 (PC)

[2] *Campbell v Myers* [1977 2 NZLR 225 (CA).

third party has only served the counterproductive purpose of adding to the total cost of resolution.

9. The current evolution of litigation funding reflects the increasing complexities of our society and its collective demand for accountability wherever those responsible for performing prescribed duties are alleged to have inflicted loss or damage by acting negligently or recklessly. Increasingly, however, those who seek financial recourse are unable to pay for it. Government funded civil legal aid has proven unsatisfactory except in family law cases. It is necessarily a cumbersome and limited avenue of financial support .

10. Litigation funding has filled a gaping void but only, it must be added, in the very limited class of cases where the financial aggregation of individual claims makes funding financially viable. The vast majority of those who are unable to afford the cost of litigation are not attractive to funders. So the underlying problem of access to justice remains . One consequence has been the increasing resort to self - representation. There have been some notable successes, particularly in the human rights area, but as a generalisation it is an unsatisfactory development. It has compounded delays, added to costs for defendants, and exhausted disproportionate amounts of the Courts' resources as plaintiffs venture into an unfamiliar system without the knowledge and discipline required to formulate legal argument.

11. It should also be recorded that litigation funding has grown under a different, less visible guise in recent years through the increasing prevalence of contingency funding arrangements between lawyers and clients. It is not my purpose to comment on their place or value except to note the obvious ; that these arrangements frequently place the lawyer in a position where he or she acquires a direct financial interest in the result and thus of conflict with his or her client.

Regulation

12. Litigation funding in New Zealand is largely unregulated. Its operation hangs loosely on one statutory provision, applicable to class actions[3]. As a result, New

[3] R 4.24 High Court Rules.

Zealand judges have had to develop their own rules for regulating the application of litigation funding and then only for class actions[4].

13. The issues which first engaged the New Zealand courts were twofold, and interrelated. The first issue was concerned with the threshold question of whether litigation funding arrangements were an abuse of process – by 2010 the Court of Appeal had decided that, while there is a risk that commercial funding could lead to oppressive litigation, the risk could be managed by High Court approval of arrangements and supervision[5]. There is no impediment in law to financing litigation for profit. That landmark decision effectively determined the conceptual debate, once and for all. However, the Supreme Court has added an important qualification, reciting that litigation funding arrangements can be reviewed within the Court's supervisory function if they amount to an assignment of a bare cause of action or are otherwise shown to offend public policy.[6] The Supreme Court also affirmed it is not the role of the courts to act as general regulators of litigation funding arrangements to scrutinise (a) the level of control held by the funder over the terms on which claims may be settled; (b) the funder's percentage share of the proceeds; (c) whether the arrangement extends to indemnifying the funded litigant against an adverse costs order; and (d) the contractual basis on which the funder may withdraw funding part way through the process[7].

14. The related issue question was whether funded proceedings should be permitted on an 'opt in' or an 'opt out' basis; that is (1) ' opt in' where the proceeding would only be brought for those members of a class who expressly agree to be part of the litigation, and for whose exclusive benefit it is run, or (2) 'opt out', in that the proceeding is deemed to be brought for all members of the affected class unless they affirmatively advise to the contrary. The Court of Appeal decision in *Ross*[8] has now settled that question in favour of the 'opt out' argument. Access to justice is the governing public policy factor along with facilitating an efficient use of judicial resources.

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5 *Saunders v Houghton* 2010 [3 NZLR] 331

6 *Waterhouse v Contractor's Bonding Ltd* [2014] 1 NZLR 91 at [56] – [59]

7 *Waterhouse* at [20[- [29]

8 See; *Saunders v Houghton* [2013] 2 NZLR 652 (CA); *Ross v Southern Response* 2019 [NZCA] 431 at [38 – 54]; *Cridge v Studorp Ltd* 2017 [NZCA] 376 at [11]; *Credit Suisse Private Equity v Houghton* 2014 [1 NZLR] 541 (SC).

15. Also, the Court noted in *Ross* that 'opt out' arrangements "*would also strengthen the incentive for insurers and other large entities dealing with the public to comply with the law, and increases the prospect that they will be held to account for any breach of their obligations to large numbers of individuals in circumstances where individual claims may not otherwise be pursued*". An important practical consideration is the 'opt-out' approach will likely result in an increase in the numbers of a class who participate- in *Ross* there were 3000 potential members of the aggrieved class. By contrast, an 'opt in' arrangement significantly limits an institutional defendant's exposure.

16. The pragmatic effect of *Ross* should be noted. As in many class actions, counsel recognised that the trial would necessarily proceed in two stages. The claims could proceed on an opt-out basis for determining liability at the first stage; the issues of contractual interpretation were common to all members. However, the claims would have to proceed on an opt- in basis at the second stage of assessing loss if liability was proven.

17. The absence of a regulatory framework is unsatisfactory, from the prospective of all interested parties. There are some advantages arising from the broad flexibility inherent in addressing claims on a case by case basis. But it is also costly and leads to uncertainty as the parties' frequently wrangle over procedural issues. It causes delay and adds to expense, and creates uncertainty for funding arrangements.

18. Numerous attempts have been made to formalise our litigation funding regime. In 2009 the Rules Committee drafted a comprehensive bill but its progress into litigation was halted by some in high places. However, good sense has now prevailed. Both the Law Commission and the Rules Committee are considering the issue with the objective of providing an ordered set of rules which is likely to codify and expand the existing body of law. However, as I shall later observe, it is distinctly possible that our Parliament will follow Australia's lead and require a higher level examination of the place of litigation funding in our wider societal landscape.

19. Litigation funding arrangements are not of course limited to class actions. The Mainzeal litigation is an example of an exception[9] although of course it was a

[9] *Mainzeal v Yan* 2019 [NZHC] 255

claim brought by a liquidator on behalf of a body of unsecured creditors. The other significant claims are by shareholders against former directors and financial institutions[10]; owners of leaky homes pursuing product liability claims against a multinational manufacturer[11]; kiwifruit growers claiming against the Government in negligence[12], alleging that Government breached its duty of care to growers by allowing a consignment of pollen to be imported which carried a virulent bacteria; owners of properties damaged in the 2011 Christchurch earthquake[13]; customers of major trading banks alleging deceptive practices in fixing charges and selling products. It is fair to assume that the number of representative actions will continue to grow in the post COVID-19 environment.

20. These developments have a major affect on insurers, not just those in the position of direct liability under contractual relationships for property damage (such as arising from the 2011 Christchurch earthquake), but also, more significantly, as liability indemnifiers of directors and officers of companies, of local authorities, of professional bodies (particularly auditors and lawyers associated with failed companies) and product liability indemnifiers. The particular exposure in the latter category is to the momentum built by class actions , by the aggregation of small claims, and the substantive and procedural issues arising. Some were raised and rejected in *Ross*[14] but they remain significant and are likely to feature in argument on appeal to the Supreme Court. The procedural costs burdens of dealing with either opt-in or opt-out claims are high. An aggregation of claims builds its own momentum – strength in numbers- and insurers like other well resourced institutional defendants must confront the expectations of agreeing to fund large settlements irrespective of the merits. Trials split on liability and damages are expensive. Insurers may have think laterally, to introduce their own internal dispute resolution provisions outside of the formal court processes.

Australia

21. Australia has confronted these issues. Its class actions are, of course, on a much grander scale. Its market is much more sophisticated and competitive, and has

[10] *Houghton v Sanders,* at n7 above

[11] *Cridge*, at n8 above

[12] *Attorney General v Strathboss Kiwifruit Ltd* 2020 [NZCA] 98

[13] *Ross,* at n8 above

[14] **Ross, at n8 above, at [77] –[80] and [100] –[110]**

been operational for over 20 years across a range of jurisdictions in a much more diverse economic setting.

22. Legislation was recently introduced in Australia. Since 22 August 2020, all litigation funders are required to hold Australian Financial Services Licences and are required, where necessary, to comply with managed investment scheme rules. It is important however, to keep this in perspective. The percentage of class actions filed in the Federal Courts of Australia was less than 1% of all causes of action[15], although this figure would be arguably misleading because such claims are likely to commit a much greater proportion of the court's hearing resources. Funding models there take a number of forms. The class actions are also of a wider scope. They include shareholder and investor, consumer law, medical, financial products, environmental, human rights and employee actions.

23. The regulation introduced in Australia is likely a reflection of federal government policy that prefers businesses to focus on remaining in business rather than "*fending off class actions funded by unregulated and unaccountable parties*". The core criticism is that unmeritorious class actions are often funded with inadequate compensation shared between plaintiffs and funders. The response has been obvious. Funders characterise the Government's policy as an attack on access to justice, pointing out that continuous and open disclosure is fundamental to market integrity and should not be diminished.

24. Parliament has now set up a Joint Committee on Corporations and Financial Services, with a reporting date of 7 December 2020, to provide a report within terms of reference including:

(a) the likely future impact on broader economy if class action cases continue to grow at their current rate;

(b) the impact of litigation funding on damages and other compensation received by class members and class action;

[15] Integrity, Fairness and Efficiency, An Enquiry into Class Action Proceedings and Third Party Litigation Funders, Final Report, Australian Law Reform Commission, ALRC Report 134, December 2018 at para 3.13

(c) the financial and organisational relationships between litigation funders and lawyers representing plaintiffs in funded litigation and the capacity, if any, to affect duties owed by the plaintiff's lawyers to their client;

(d) the consequences of allowing Australian lawyers to enter into contingency fee agreements or courts to make costs orders based on a percentage of any judgment or settlement;

(e) the effect of unilateral legislative and regulatory changes to class action procedure; and

(f) the application of common fund orders and similar arrangements in class actions.

25. As noted, Australia has a different commercial environment, with about 30 companies in the litigation funding market. Interestingly, some of the funders fund claims for an orthodox or familial arbitral proceeding, often for relatively modest amounts. Questions have arisen in Australia about the impact of legislative changes on lawyers who themselves fund or carry the contingent costs of litigation. At a very basic level in New Zealand there is anecdotal evidence of advocates funding personal grievance claims before the Employment Relations Authority and the Employment Court, rewarded by an agreed share of the proceeds of a favourable compensation award. Other lawyers are said to be operating truly contingency fee schemes.

26. Questions also arise about what will happen throughout Australasia after both countries emerge from the COVID-19 economic blows. The most obvious area of risk is company failures with the likely increase in premiums for directors' and officers' liability in professional indemnity insurance. In Australia, of course, the law firms specialising in this work are larger, more aggressive and better funded than resourced in New Zealand firms.

27. It is of interest that the Law Council of Australia has submitted to the Parliamentary Enquiry into Litigation Funding and the Regulation of the Class Action Industry that contingency fee arrangements should not be supported, on the premise that potential marginal gains and access to justice are outweighed by the risks to the ethical duties of lawyers and the potential effects that compromising these duties might have on the interests of class members.

Nevertheless, the Law Council supports litigation funding as a model for promoting access to justice, spreading the risk of complex litigation and approving the efficiency of litigation by introducing commercial considerations which will aim to reduce costs. The Council favours regulation by authorising increased oversight by the Courts, particularly common fund orders. In the Council's experience, competitive pressure introduced by the CFO regime (Common Funds Orders) has had a positive downward impact on commissions charged and increased the transparency of litigation funding arrangements.

28. In my view it is only a matter of time before New Zealand moves to a more regulated model for litigation funding, despite Nicky Chamberlain's constructive research showing that only 36 class actions have been brought in New Zealand since the 1980s, with just four being funded by third parties. The Law Commission Paper and the Rules Committee's Report will provide the necessary foundation for legislative intervention.

29. However, the wider issues raised by the Australian Parliamentary Enquiry are certainly likely to feature. New Zealand will have to ask itself the same questions. For example, what impact will litigation funding have on future damages awards and what will be its economic effect? This policy question is current in a number of English-speaking countries. There is a sense of disquiet in the USA about the distortionate effect on the economic behaviour of the widening tentacles of tort liability. Another issue, of direct relevance to the legal profession , is : to what extent is legislative control of contingency fees arrangements and relationships between certain lawyers and litigation funders necessary? The adequacy of the existing civil legal aid regime may also fall for review. There is also the as yet untapped prospect of substantial claims against the government by disaffected iwi, whether relating to treaty settlements or otherwise, and of claims against government agencies and private entities by those adversely effected by climate change

BMW Australia Limited v Brewster[16]

[16] *BMW Australia Ltd v Brewster* 2019 [HCA] 45

30. It is worth considering the current state of Australian jurisprudence in this area. Some of the deeper philosophical issues inherent in the world of class actions and litigation funding were brought to the fore by the recent decision of the High Court of Australia in *BMW v Brewster*. At the hub of the case was the statutory validity of CFOs.

31. Common fund orders were a generally accepted judicial response to the perception that free riders, those who had not specifically opted into a proceeding as a member of the claimant group, could share in the benefits of a successful outcome without having to contribute to the costs. CFOs satisfied the funders commercial imperative because they were spared the cost and inconvenience of 'book building', signing up potential group members to a funding arrangement. In general, CFOs provide for the amount of litigation funder's remuneration to be fixed at a proportion of any moneys ultimately recovered; for all group members to bear a proportionate share of liability; and for liability to be discharged as a first priority from recoveries.

32. The High Court heard two appeals, by BMW and a companion appeal in *Westpac Banking Corporation v Lenthall*. The question was whether certain federal and state legislative provisions empowered Courts of primary jurisdiction to make CFOs. The lower Courts, confirming practices widely applied, endorsed the making of CFOs at early stages of representative proceedings. The lower Courts had relied on a statutory provision to the affect that in any proceeding a Court had a wide power to "*make any order the Court thinks appropriate or necessary to ensure that justice is done in the proceeding*". The lower Courts had construed this provision as entitling them to make CFOs so that justice was done in the proceeding.

33. However, a majority ruled to the contrary, finding that the statutory provision only *related to justice as between the parties to the proceeding*. The litigation funder was not "a party" : it was beyond the purpose of the legislation for the Court to make an order at the outset, to assure potential funders of a sufficient level of return on their investment to secure support for the proceeding. In the majority's view the only real rationale for making a CFO was to ensure the commercial viability of the litigation from the funder's perspective. That factor had nothing to do with ensuring that justice was done – that is justice between the parties. The ends of justice were not required to provide a sufficient financial inducement for a funder to join the proceeding.

34. Part of the rationale for this decision was that a Court should not be sanctioning the establishment of a complex relationship between the group members and the funder which would not otherwise exist and, in particular, that fixing a rate of remuneration at the outset is necessarily highly speculative. In recognising the problems created by free riding, the majority sanctioned the practice of funding equalisation orders which could operate to share the expense of funding the proceeding: these orders operate by deducting from the recoveries of non funded class members the amount equivalent to the funding commissions or fees which would otherwise have been payable by them as funded , thus redistributing the additional amounts received in hand by unfunded class members pro rata across the class as a whole. However, the majority saw no principled reason for redirecting the amount recovered by a unfunded member to a funder with which the member had no legal relationship. In the majority's view, the occasion for making such orders was at the conclusion of the proceeding where the value of the fund is support to the group members was able to be assessed and recognised.

35. The relevant circumstances of each appeal can be stated shortly, and illustrate the philosophical problems arising.

(a) **BMW**

This was a class action for the national recall of vehicles fitted with defective airbags. The potential claimants comprise over 200,000 members with "*distinctly modest claims for damages*". . Of the potential 200,000 members, only 33 had entered into a contract with the litigation funder , Regency Funding Pty Limited, which had agreed to bind itself to maintain the litigation, and only 116,000 had shown an interest in doing so – "*a tiny proportion of the whole*". As Gordon J observed[17], there appeared to be "*little appetite*" for litigation.

(b) **Westpac**

A number of customers of Westpac issued proceedings against the bank alleging that it had breached its statutory and fiduciary obligations to them by advising customers to purchase insurance policies from Westpac Life

17 At 159-160.

when it knew there were equivalent or more advantageous policies offered by other insurers. While a relatively small number of customers had issued the proceeding, there were potentially in excess of 80,000 members, each with a claim for damages in the range of $2,000 to $15,000. Only one litigation funder, JKL, had shown any interest in funding the proceeding. By the time it entered into a CFO, JKL had spent approximately $1.2 million on legal costs, with future costs estimated to be between $6.5 million and $9 million.

36. There are obvious problems with the remedy proposed by the majority. Without a guaranteed return from a significant award of damages or settlement, a litigation funder will not participate, especially where the amount of each claim is small. Their success depends on the aggregation of claims. Some of problems with the majority's approach are highlighted by the dissenting judgment of Edelman J. He was satisfied that CFOs were "*appropriate or necessary to ensure that justice is done in the proceeding*" by requiring those who obtain the benefit of a litigation funding service, including the benefit of risk and cost incurred by the litigation funder, to bear a proportionate share of the reasonable remuneration for the service.

37. As noted, one consequence of the High Court's decision is that it will likely cause funders to revert to the problematic practice of book building. To that extent, litigation funders seek to identify group members, create awareness in a litigation and enrol them as plaintiffs through media and web communications. In Australia a number of plaintiff law firms set up web pages to advertise class actions that they are running. Perceived advantages of a CFO, which the majority rejected, was to obviate the expense and difficulty involved in building a book or encouraging participation in class actions.

38. However, the majority in *Brewster* were unimpressed by this argument, noting that it was not the Court's function[18] to "*ease the commercial anxieties of litigation funders or to relieve them of the need to make their decisions as to whether a class action should be supported based on their own analysis of risk and reward".*

39. This statement sounds fine in principle. But the inevitable consequence will be the unlikelihood of a funder continuing or the litigation proceeding, That result

[18] **At [94]**

would be antithetical to the objectives which lay at the forefront of the reasoning in *Ross.;* opt out orders ensure that the gross return on a judgment or a settlement is available to be pooled to meet all legal costs.

Summary

40. The majority's rationale in Brewster also raises fundamental concerns that go to heart of the ability of our judicial system to deliver justice in a particular case: is it right that a financial institution - if it has indeed breached its legal duties to a range of its customers – should be able to retain the huge financial benefit of its wrongdoing ($80 million +) at the expense of customers who individually are unable to afford the cost of pursing their legal rights?[19]

41. On the other hand, is it right that the litigation funder of a relative handful of disaffected owners of BMW motor vehicles could build on the based of that minute number of claimants and obtain a direct financial benefit from pursuing claims for other owners who have shown no interest in participating? The observations of Gordon J are apposite. [20]Is the lack of interest due to a disinterest on the part of the vehicle owners, whose vehicles' defective airbags had been replaced? Or was it because the funder had undertaken little book building, appreciating that the level of disinterest so far suggested that those book building costs were likely to be wasted and irrecoverable? A CFO would spare the funder those costs, and guarantee a "handsome rate of return from the aggregate of damages which may ultimately be recovered".

42. The judgments in *Brewster* throw up often irreconcilable philosophical differences about the justification for and effect of litigation funding. One is the dominant objective of preserving access to justice and efficiency of resources together with ensuring an equality of bearing the costs burden of all who may benefit from funded litigation through the clean mechanism of CFOs; Opt out orders go a long way to meeting those same objectives. The other is the underlying theme of the majority's reasoning, combining a degree of contractual purity or principle, disquiet about lending judicial support to the commercial imperatives underpinning a litigation funder's participation and a sense that those

[19] **Ross at [99]**

[20] **Brewster at [160]**

imperatives were driving the litigation, particularly in the BMW proceeding, and invoking unspoken notions of champerty and maintenance,

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15 September 2020