IN THE CANTERBURY EARTHQUAKES INSURANCE TRIBUNAL

CEIT-0024-2020

IN THE MATTER OF	CANTERBURY EARTHQUAKES INSURANCE TRIBUNAL ACT 2019
BETWEEN	LS Applicant
AND	MEDICAL INSURANCE SOCIETY LIMITED Respondent

Date: 22 March 2021

Appearances: On the papers

DECISION NO 2 OF MEMBER C D BOYS

[LITIGATION FUNDING AGREEMENT]

22 March 2021

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[1] In making a claim to the tribunal LS is funded and represented by a third-party funder and advocacy service; My Insurance Claim[1] (MIC) (the funder) The funding is provided under the terms of a written agreement (the agreement). Medical Insurance Society (MIS) has concerns about whether clauses in the agreement could create a barrier to the settlement of the claim. Consequently, MIS has applied for terms to be inserted into the agreement to eliminate the potential barrier. The application raises wider issues around litigation funding, abuse of process, and the jurisdiction of the Tribunal to manage applications brought before it. These issues have potential effects for a number of claims which fall within the Tribunal's jurisdiction. This decision addresses these issues, concluding that the agreement is to be changed to provide for independent advice to be sought by the homeowner in the event that a conflict arises. This will address the potential barrier MIS is concerned about and provide a safeguard for the homeowner against any conflict.

[2] The funder receives a fee for providing funding and advocacy services which is recouped from any settlement its clients receive. The arrangement is not unusual; I am aware of other advocacy services which offer, or have offered, similar services for Canterbury Earthquake Sequence affected homeowners. Because there are potential conflicts of interest between the funder's roles as adviser and as funder, which may affect the management and adjudication of LS's application, I made orders at the first case management conference for the agreement to be disclosed.

The parties' memoranda

[3] MIS' counsel, Mr Frith, filed a memorandum dated 23 December 2020, setting out concerns that certain clauses in the agreement may act as a barrier to settlement. MIS says the application of these clauses could prevent LS from accepting a reasonable settlement offer as the fees he owes the funder could exceed the settlement funds. Mr Frith has cited *Cain v Mettrick*[2] in which the High Court found that similar clauses gave rise to prejudice against the plaintiffs. In *Cain* Paulsen AJ found that there was an abuse of process because the funding agreement gave the funder excessive control over the litigation.[3]

[1] Formerly Risk Worldwide.
[2] *Cain v Mettrick* [2020] NZHC 2125 at [60].
[3] *Cain v Mettrick* [2020] NZHC 2125 at [63].

[4] Mr El Sawaf for LS filed a response memorandum dated 14 January 2020. *Cain v Mettrick* is distinguished due to differences in the wording of the funding agreements, and the factual differences between the two cases. Underlying the facts of *Cain* were allegations of misfeasance, and an allegation that that the funder intended to do political harm to one of the plaintiffs. The funder opposes the amendment to the agreement as the disputed clauses apparently protect its investment of time and funds that have been made available to LS in pursuing the insurance claim.

[5] MIS filed a memorandum in reply on 19 February 2021. This makes clear that a stay of proceedings is not sought, and that MIS does not allege that the funding agreement gives rise to an assignment of a bare cause of action and therefore amounts to abuse of process. Rather, its concerns are that;

(a) The funder may use its ability to cancel the agreement to pressure LS into accepting an offer he would not otherwise, and

(b) that after reinstatement LS will be left with a debt due to the funder, which he will need to meet out of his own funds.

[6] To deal with these potential issues MIS has invited me to direct the funding agreement is amended, as follows:

> notwithstanding anything else in this agreement, [LS] will not be required to pay an amount to [the funder] that is, or may be, in excess of the amount of money that you actually received in cash from your insurer.

[7] Mr El Sawaf, relying on comments of the Supreme Court in *Waterhouse v Contractors Bonding Ltd*[4], argues that MIC is allowed a degree of control in order to protect its investment. Mr Frith says that this is incompatible with the purposes of this Tribunal to "*provide fair, speedy, flexible, and cost-effective services for resolving disputes*"[5].

[8] There are several issues which must be considered when deciding whether MIS's invitation should be accepted:

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[4] *Waterhouse v Contractors Bonding Ltd* [2014] 1 NZLR 9.
[5] Canterbury Earthquakes Insurance Tribunal Act 2019, s3.

(a) whether I have the jurisdiction to make the order sought;

(b) the legal requirements for making such an order; and

(c) whether the order is justified.

Jurisdiction

[9] This Tribunal's jurisdiction is established by the Canterbury Earthquakes Insurance Tribunal Act 2019 (the Act).

[10] **Section 3 Purpose**

> The purpose of this Act is to provide fair, speedy, flexible, and cost-effective services for resolving disputes about insurance claims for physical loss or damage to residential buildings, property, and land arising from the Canterbury earthquakes.
>
> …

[11] **Section 8 Application of Act**

> (1) This Act applies to disputes between policyholders and insurers about insurance claims for physical loss or damage arising from the Canterbury earthquakes to a residential building or residential property.

[12] **Section 46 Tribunal's decision: substance**

> (1) The tribunal may make any order that a court of competent jurisdiction could make in relation to a claim in accordance with the following:
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> …
>
> (b) the general law of New Zealand, in particular,—
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> (i) the law of contract as it relates to contracts of insurance:
>
> (ii) the Earthquake Commission Act 1993.

[13] Clause 1 of Schedule 2:

> **1 Procedure**
>
> The tribunal may regulate its procedures as it thinks fit, subject to—

(a) this Act and any regulations made under it; and

(b) any practice notes issued under clause 2.

[14] The regulation of funding agreements has been considered at the highest appellate level. In *Waterhouse v Contractors Bonding Ltd*[6] the Supreme Court ruled that a Court has inherent powers to stay proceedings for abuse of process. The inherent powers referred to are necessary to prevent the use of a Court's (or Tribunal's) procedure to create manifest unfairness against a party. This extends to the oversight of litigation funding arrangements of parties before the Court or Tribunal[7].

[15] The agreement is a contract between LS and the funder. The funder is not a party to this application and which, therefore, appears to sit outside of the ambit of section 8. However, statutory courts, such as the District Court, have ancillary powers which enable them to operate effectively within their defined jurisdictions.[8] Section 46 (1) allows the Tribunal the power to make the same orders as a court of competent jurisdiction in accordance with the general law of New Zealand. Clause one of Schedule two allows the Tribunal to regulate its procedure as it sees fit. Therefore, I have the same ancillary powers afforded to other courts to regulate matters before me and have the jurisdiction to make the orders sought.

The law

[16] The law around the governance of litigation funding agreements is founded in the two doctrines of champerty and maintenance. They are medieval in origin and were originally intended to protect against the powerful or wealthy using court procedures in an oppressive manner. Maintenance involves a person with no interest in a matter encouraging a party to bring a lawsuit, whereas champerty is a form of maintenance where the third party seeks to make a profit from such encouragement. The doctrines were developed when the Courts had limited powers and procedures to protect parties.[9]

[17] In the modern context the applications of maintenance and champerty have raised issues around access to justice. The expense of litigation has led to the development of litigation

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[6] *Waterhouse v Contractors Bonding Ltd* [2014] 1 NZLR 91 at [30].
[7] Although the oversight does not extend to the fairness of bargain set out in the litigation funding arrangements. See *Waterhouse v Contractors Bonding Ltd* [2014] 1 NZLR 91 at [29].
[8] *Zaoui v Attorney General* [2005] 1 NZLR 666, at [64].
[9] See Stephen Todd *The Law of Torts in New Zealand* (6th ed, Thompson Reuters, Wellington, 2013) at 18.5.

funding, without which cases with merit could never be pursued. Litigation funding is champertous, as the funder has no interest in the litigation, beyond profit. This development led the Court of Appeal in *Saunders v Houghton* to state[10]:

> We have concluded that, like the common law of Australia and that of Canada, the common law of New Zealand should refrain from condemning as tortious or otherwise unlawful maintenance and champerty where:
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> (a) the court is satisfied there is an arguable case for rights that warrant vindicating;
>
> (b) there is no abuse of process; and
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> (c) the proposal is approved by the court.

[18] In *Waterhouse v Contractors Bonding Ltd*[11] the Supreme Court considered a litigation funding agreement would amount to an abuse of process where the agreement amounts to an assignment of a bare cause of action. Such an assignment occurs where a right to sue is transferred to another without the transfer, or prior possession, of another legitimate interest in the subject matter of the dispute. For example, the purchaser of a damaged property which is subject to an unsettled claim may legitimately sue to settle the claim, provided the claim is validly assigned along with the damaged property.[12] However, the bare right to sue, without a similar legitimate interest, cannot be transferred. This is because such an assignment effectively removes the original litigant from the dispute, and leaves no real dispute between the parties, running contrary to the purposes of the litigation process.

[19] *Waterhouse* lays out the following test:

> In assessing whether litigation funding arrangements effectively amount to an assignment, the court should have regard to the funding arrangements as a whole, including the level of control able to be exercised by the funder and the profit share of the funder. The role of the lawyers acting may also be relevant.[13]

[20] These criteria were discussed by the Court of Appeal in *PricewaterhouseCoopers v Walker*[14]. The Court's commentary on the level of control and the role of counsel adds nuance to the *Waterhouse* considerations:

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[10] *Saunders v Houghton* [2010] 3 NZLR 331 at [79].
[11] *Waterhouse v Contractors Bonding Ltd* [2014] 1 NZLR 91.
[12] As occurred in *Xu v IAG* [2019] NZSC 68.
[13] *Waterhouse v Contractors Bonding Ltd* [2014] 1 NZLR 91 at [57].
[14] *PricewaterhouseCoopers v Walker* [2016] NZCA 338 at [14].

> (c) When considering whether a funding arrangement is in substance a bare assignment of a cause of action a court should consider the arrangement as a whole, including the funder's degree of control and share of profits.
>
> (d) The role of the lawyers acting may be relevant in the inquiry into a funding arrangement. Here the Court instanced a representative action in which the plaintiff's lawyers reported to the funder and in addition to their usual fees took an undisclosed success fee from the funder, conflicting with their duty to act only in their lay clients' interests. These features exacerbated the majority's concern that the funder, which had referred plaintiffs to the lawyers, was trafficking in litigation.
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> (e) The traditional categories of abusive proceedings include those that deceive the court, are fictitious, or a mere sham, those that use the process of the court in an unfair or dishonest way or for some ulterior or improper purpose or in an improper way, those that are manifestly groundless, without foundation or serve no useful purpose, and those that are vexatious or oppressive[15]

[21] In *Cain v Mettrick*[16] the defendant applied for a stay of the plaintiff's claim on a number of bases including that the litigation funding agreement and the circumstances of the funding were an abuse of process.

[22] Paulsen AJ discussed the criteria for abuse of process:

> As noted earlier, the court does not have a role in gauging the fairness of the bargain between a funder and plaintiff. The court will have regard to the funding arrangements as a whole, including the level of control able to be exercised by the funder and the profit share of the funder. The role of the lawyers acting may also be relevant. Any consideration of control should be linked to potential legal control and not potential de facto control of the litigation. Some measure of control by a funder is inevitable to enable a litigation funder to protect its investment. Not to allow sufficient control may reduce unmeritorious claims, but at the expense of denying access to the courts for legitimate claims.[17]

[23] The rationale is whether the funding agreement gives the funder such a level of control or profit that the funder, rather than the litigant, "owns" the litigation. This would be, in effect, an assignment of a bare cause of action. Some control allows for a funder to protect their commercial interests. However, if an agreement allows the funder more control than the litigant, it would be questionable whether the interests being served are those of the litigant or the funder.

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[15] *PricewaterhouseCoopers v Walker* [2016] NZCA 338 at [14]
[16] *Cain v Mettrick* [2020] NZHC 2125
[17] *Cain v Mettrick* [2020] NZHC 2125, at [49]

[24] Similar considerations arise as whether the funder or the litigant benefit from the litigation. A reasonable profit is permissible, but if the funder's share of profits is unreasonable then it would indicate that the litigation process is being used illegitimately.

[25] The question is where the balance lies and what is reasonable in the circumstances. This will require consideration of:

(a) the particular wording of the agreement;

(b) wider market considerations of the profit and fees being taken;

(c) the relationship between counsel and the funder; and

(d) other factors which may influence the balance of control between the funder and the claimant, such as whether the claimant is under any hardship or vulnerability.

The agreement

[26] The agreement at clause 2 sets out a purpose of "*provid*[ing] *assistance in the preparation, presentation and resolution of* [LS's] *claim"* in return for "*professional fees and disbursements*".

[27] Clauses 5 and 6 govern the payment of fees and disbursements:

> PROFESSIONAL FEES AND DISBURSEMENTS WHEN PAYABLE
>
> 5. [the funder] will only charge you professional fees and disbursements upon the successful *outcome* of the claim or if this Agreement is terminated in accordance with the relevant clauses below.
>
> 6. If your claim is *unsuccessful,* you will not be liable to pay our *professional fees* or any *disbursements* incurred on your behalf.

[28] The fees are calculated as "*15% of the GST inclusive value of the successful outcome*". *"Successful outcome*" is defined as recovery of "*money or money's worth*" greater than the incurred disbursements. The inclusion of "*money's worth*" is for the contingency that the outcome is a repair, or remuneration of incurred repair costs, rather than the payment of a cash settlement.

[29] Clause 8 is a mechanism for defining a successful outcome when there is disagreement between the parties:

> 8. The *successful outcome* of the claim is achieved in any of the following cases:
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> …
>
> (e) Where you do not accept the insurer's and/or EQC's offer or such settlement as the insurer and/or EQC proposes *(recommended offer*), despite [the funder]'s recommendation that you accept such an offer then the *recommended offer* shall be deemed the value of the *successful outcome.*

[30] The agreement allows for cancellation in a manner relevant to the questions before me:

> 28. [the funder] will not continue to do the work:
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> …
>
> (c) if you fail to accept advice [the funder] gives you including, but not limited to, your failure or refusal to accept any *recommended offer* despite [the funder]'s recommendation that you accept such an offer.
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> ...
>
> (e) if [the funder] forms the view, based on advice from a solicitor or barrister that there are no longer reasonable prospects of success.

Discussion

[31] MIS has clarified that it does not seek a stay and does not allege that the funding agreement is an abuse of process. However, the Tribunal's jurisdiction rests only on the inherent power to prevent an abuse of process. I am not aware of any other legal or procedural rule which would allow me to interfere in a contract between an applicant and a third party.

[32] The agreement allows the funder control over the termination of the agreement under the conditions set out in clauses 28(c) and (e). This control, combined with the way that the fees and disbursements are calculated, raises a risk that LS could be left to fund either the funder's fees, and/or any shortfall in rebuild/repair costs out of his own pocket. MIS' concern is that this control could be used to pressure LS to accept an offer he would not otherwise accept. I am not persuaded that this level of control is prejudicial to LS.

[33] In the normal course of litigation, it is not uncommon for the legal expenses to eat into claim funds, as costs awards rarely cover the full expenditure.[18] Any settlement based on a compromise to accept a lesser sum than initially sought involves inherent cost pressures. A competent lawyer advising a client on a settlement will invariably provide their client with a cost benefit and risk analysis of continuing the litigation. The control the funder has over the termination of the agreement does not allow it to take charge of the decision making, which remains with LS, albeit under some risk of debt. I note that in *Cain v Mettrick* the control in the offending clause obliged the plaintiffs to continue the litigation against their will, if the funder insisted.[19] In the present case, any control the funder has is conditional, and of a practical rather than legal nature. This level of control is not enough to constitute the assignment of a bare cause of action.

[34] The professional fees allowed for are reasonable. I am aware of similar agreements in Earthquake list litigation, where the fees charged varied between 5% and 25% of the final settlement. An unjustifiably high level of profit would raise a real prospect that the litigation is principally for the profit of the funder, a collateral or ulterior purpose. This would signal that the funder "owned" the litigation, an assignment of a bare cause of action.

[35] The amendment, if imposed, would reduce MIC's ability to recover a fee for its time spent managing the claim, advising LS and advocating for him. The amendment would in effect shift the risk of a low settlement from LS to MIC. Perversely, this runs the risk of incentivising MIC to advise LS not to accept an otherwise reasonable offer, if it would leave MIC with a shortfall. The amendment goes to the fairness of the bargain between LS and MIC. Given this, an order requiring the amendment is not justifiable.

[36] My assessment occurs in the context of CEIT litigation. Unlike the High Court where different Judges manage and hear matters, this Tribunal uses a docket system with a single member managing and presiding, allowing for a high degree of oversight. In comparison with the High Court, this Tribunal exercises more intensive case management. This Tribunal is an inquisitorial forum, which means that the presiding member may make wide enquiries and consider issues not put before them by the parties. It is also worth noting that many settlements

[18] Particularly so under the limited costs jurisdiction in the Act.
[19] *Cain* v *Mettrick* [2020] NZHC 2125, at [62].

occur during settlement conferences overseen by Tribunal Members. These factors combine to mitigate the risk that LS will be prejudiced by the application of the agreement.

[37] LS is a qualified XXX, he is intelligent and capable, there is no apparent vulnerability which affects him with regard to the agreement. However, there is vulnerability, inherent in the circumstances of the agreement, which would affect any lay applicant in an area which the Tribunal cannot oversee; the advice given by an advocate to the applicant they represent. In this case the funder occupies the roles of litigation funder, advocate, and adviser to LS. The clauses in the agreement which are discussed above are designed to protect the funder's interests. If the funder invokes clauses or 8(e) or 28(c) a conflict arises between its financial interests, as funder, and its ability to provide LS with independent advice, as adviser. This is not to say that the funder has acted or will act improperly, but that the way the agreement is structured raises the potential.

[38] As discussed above the Tribunal's jurisdiction extends to preventing potential abuses of process. Should a conflict arise between MIC's roles as adviser and funder there is a risk the litigation could be used for the collateral purpose of the funder's profit. This would be an abuse of process, and in an area which the Tribunal cannot oversee. This possibility can be mitigated by independent advice. I note that at clause 28(e), the agreement already provides a similar mechanism for the referral of questions to an independent barrister or solicitor. To address the issue, I order that MIC and LS modify the agreement by inserting the following clause:

> If you fail to accept or refuse to accept, any *recommended offer* despite MIC's recommendation that you accept such an offer, and MIC intends to either cancel the agreement under clause 28, or deem the value of the *recommended offer* as a *successful outcome* under clause 8, MIC will refer the matter to an independent Barrister or Solicitor, experienced in Earthquake litigation, to advise you.

C D Boys
Member
Canterbury Earthquakes Insurance Tribunal