“David v Goliath”: The case for the formal regulation of third-party litigation funding in Aotearoa New Zealand

Essay by Alastair Nisbet

Litigation is expensive. Litigants face legal fees at all stages of proceedings, as well as costs associated with case initiation, discovery, settlement discussions and mediation, pre-trial administrative hearings and conferrals, expert witnesses, interlocutory applications, the trial itself, and the cost of the project lying dormant and incomplete in the meantime. The high cost and inherent uncertainty associated with civil litigation creates a daunting financial barrier for those seeking justice for even meritorious claims. This, as well as the recent explosion of group litigation and class action lawsuits in jurisdictions outside the United States, has led to many litigants engaging third parties to finance their claim.

This practice is known as third-party litigation funding (**TPLF**). TPLF is a contractual arrangement by which a person or entity that is not naturally a party to a dispute agrees to fund the costs of prosecuting or defending a claim in exchange for a share of any recovery.[1] In the last two decades, a number of notable jurisdictions have permitted at least some form of TPLF, including Australia, Germany, Hong Kong, Ireland, Singapore, the United Kingdom, the United States, and several jurisdictions in the European Union. This recent proliferation has, unsurprisingly, attracted intense policy and jurisprudential debate. While advocates of TPLF champion improved access to justice and the levelling innate disparities in resources, its critics point to the potential for abuse and the “commodification” of justice.

Professionals in the construction sector will frequently find themselves as a defendant facing off against a plaintiff backed by a litigation funder – be it in the capacity of a contractor, engineer, or even an insurer in the context of professional indemnity cover. Building defect and defective product claims against builders, consultants, and product suppliers not infrequently have plaintiffs supported by a litigation funder. This means that, for the construction sector at least, concerns over the potential abuse of TPLF by plaintiffs and funders often dominate discussions. There will always be those who continue to raise questions about the ethics of a non-party funding a litigant’s suit, but that ship has largely sailed. TPLF is no longer a novel or even a rare phenomenon; it a mainstay in both international and domestic dispute resolution. The question now is not whether litigation funding should be permitted but how it should be regulated. This is perhaps best said by the High Court of Australia in the judgment that first liberalised the practice: *“[t]he law now looks favourably on funding arrangements that offer access to justice so long as any tendency to abuse of process is controlled”*.[2] In New Zealand alone, between 2016 and 2020, the New Zealand Law Commission (**NZLC**) identified a total of 40 instances in which a plaintiff had received litigation funding from a third party, including

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[1] Note that, while third-party litigation funders most commonly fund plaintiffs, they may also fund defendants. However, discussion in this essay will be confined to the funding of plaintiffs in civil litigation.

[2] *Campbells Cash and Carry Pty Limited v Fostif Pty Ltd* [2006] HCA 41, at 104.

claims concerning insolvency, insurance, negligence, breach of fiduciary duties, land disputes, repayment of loans, and even a suit against the government.[3]

This essay proceeds on the consensus that TPLF is not only necessary as a civic good but is firmly rooted in the contemporary legal landscape. Accordingly, discussion is focussed on methods of regulation. Due to the prevailing concerns of professionals in the construction sector and the length of this essay, discussion is confined to the concerns of defendants in civil litigation only. In assessing the prospects for regulation in New Zealand, reference will be had to lessons that can be learned from the regulatory efforts of other common law jurisdictions – in particular, Australia, Canada, the United Kingdom, the United States, and Hong Kong.

(1) The Historical Background of TPLF in New Zealand

For centuries, the funding of litigation by a non-party was *prima facie* prohibited as an abuse of process under the ancient common law torts of maintenance and champerty. Maintenance is committed where a person, without lawful justification, interferes with the disputes of others by assisting a party to bring or defend an action, thereby causing damage to the other party.[4] Champerty is committed where a person gives such assistance in consideration of receiving a share of the proceeds.[5] These torts were intended to protect vulnerable defendants from unmeritorious claims that might be pursued against them;[6] the fear being that *"the champertous maintainer might be tempted, for his own personal gain, to inflame the damages, to suppress evidence, or even to suborn witnesses"*.[7] They sought to prevent the perversion of the law into an engine of oppression – most commonly, at the time these objections were first formulated, by wealthy feudal lords pursuing their own personal agenda.[8]

However, the current legal landscape in New Zealand is very different. While, unlike most of its common law contemporaries, both maintenance and champerty persist as torts in New Zealand, our courts have expressed a strong willingness to allow them to fall into disuse.[9] In a "leaky homes" case before the High Court in 2008, Justice Heath questioned the benefit of continuing to give effect to these torts.[10] In His Honour's view, better access to justice and encouraging the settlement of litigation were two public policy reasons for reconsideration.[11] This view has been endorsed in a number of other construction contract disputes since.[12] In addition, the provision of financial support by trade unions (as well as by friends and family) is now permitted,[13] and subrogation under insurance policies no longer offends against the common law as an assignment of a bare cause of action.[14] The most recent illustration of this general trend came in May 2022 when the NZLC recommended the abolition of both torts to permit the liberalisation of TPLF more generally.[15] This recommendation is not a

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3 Te Aka Matua o te Ture | Law Commission, He Puka Kaupapa | Issues Paper 45, *Class Actions and Litigation Funding* (2021), at [14.38] and [14.32]; see also *Waterhouse v Contractors Bonding Ltd* [2013] NZSC 89, [2014] 1 NZLR 91; *Sage Securities Ltd v Rood* HC Wellington CIV-2009-485-1150, 11 November 2009; *Patel v Patel* [2014] NZHC 2410; *Williams v Auckland Council* [2015] NZCA 479, (2015) 7 NZ ConvC 96-013.

4 *British Cash and Parcel Conveyors v Lamson Store Service Co Ltd* [1908] 1 KB 1006, at 1014.

5 *Re Trepca Mines Ltd (No 2)* [1963] Ch 199, at 219-220.

6 *Giles v Thompson* [1994] 1 AC 142, at 153.

7 *Re Trepca Mines Ltd (No 2)* [1963] Ch 199, at 219-220.

8 *Thallhimer v Brinckerhoff*, 3 Cow 623 (NY Sup Ct 1824); cit. Cassandra Burke Robertson, "The Impact of Third Party Financing on Transnational Litigation," *Case Western Reserve Journal of International Law* 44, No. 1 & 2 (2011): 159-182, at 164.

9 *Auckland City Council as Assignee of Body Corporate 16113 v Auckland City Council* [2008] 1 NZLR 838 (HC), at [45]-[46]; *Waterhouse v Contractors Bonding Ltd* [2013] NZSC 89, [2014] 1 NZLR 91, at [56]-[59].

10 *Auckland City Council as Assignee of Body Corporate 16113 v Auckland City Council* [2008] 1 NZLR 838.

11 *Auckland City Council as Assignee of Body Corporate 16113 v Auckland City Council* [2008] 1 NZLR 838 at [17].

12 See *Craig v Phrudan Holdings Limited* (HC, Auckland CIV 2005-404-1935 29 August 2008) and *Houghton v Saunders* [2009] NZCCLR 13, generally.

13 *Stevens v Keogh* (1946) 72 CLR 1, (1946) 20 ALJR 161 (HCA); *Campbell's Cash & Carry Pty Ltd v Fostif Pty Ltd* [2006] HCA 41, (2006) 229 CLR 386, at [253] per Callinan and Heydon JJ.

14 *Compania Colombiana de Seguros v Pacific Steam Navigation Co* [1965] 1 QB 101, [1964] 1 All ER 216 (QB).

15 See Te Aka Matua o te Ture | Law Commission, He Puka Kaupapa | Issues Paper 45, *Class Actions and Litigation Funding* (2021), Chapter 18.

surprise. In 2017, Chief Justice Elias of the Supreme Court argued that such evolution was inevitable because *"the law in this area is based not upon fixed rules or principles but on notions of public policy which necessarily adapt to meet changing social circumstances"*.[16] These torts are rooted in outdated and antiquated versions of the legal system and have little applicability in modern litigation.[17] They were formulated in an era in which the impartiality of the judiciary was not guaranteed and the courts lacked the power prevent the wealthy from commandeering the judiciary to accrue wealth, harass political rivals, or accumulate dependents. However, modern courts have the ability to prevent the abuse of its processes and the jurisdiction to address any potential exploitation of vulnerable litigants.[18]

The ambiguity of their application, however, means that New Zealand has developed no formal statutory or administrative regime that specifically regulates TPLF. Instead, the conduct of litigation funders is ostensibly regulated by maintenance and champerty (at least insofar as it is still held to apply to abuse of process), the inherent jurisdiction of the court to prevent abuse of process, and various extraneous laws that, to differing degrees, serve to place legal limitations on the legitimacy and application of funding agreements.[19] This status quo is insufficient to cope with the rapid growth and complexity of TPLF.

(2) The Importance of Regulation

In much the same way as its advocates trumpet the benefits of TPLF, there are also those who argue that regulation is essential to combat abuse. There are genuine concerns from every dimension, affecting both defendants and plaintiffs, as well as counsel and the courts. The concerns of plaintiffs are generally related to the potential for consumer exploitation. They involve diminishing control over litigation strategy and decisions surrounding settlement, the termination of the TPLF agreement, misaligned incentives between the plaintiff and funder, and conflict management. The concerns of counsel revolve around the role of the lawyer and conflicts of interest – concerns that will inevitably necessitate amendments to the Lawyers and Conveyancers Act (Lawyers: Conduct and Client Care) Rules 2008. The courts are distracted by more general ethical concerns – encouragement of frivolous litigation, the idea of "trafficking in litigation", abuse of process, funders fees, and the so-called commodification of justice. These issues alone indicate the general need for formal regulation or oversight in New Zealand.

As noted earlier, this essay focuses on the issues of concern to defendants. While not exhaustive, this essay addresses three of the most pressing concerns: (1) whether the courts should mandate the disclosure of a funding agreement; (2) the extent to which a litigation funder can be held liable for security for costs or for adverse costs if the plaintiff is unsuccessful; and (3) what happens when, in the absence of capital adequacy requirements, the funder can no longer support the cost of litigation or cover adverse costs.

(3) Disclosure of the TPLF Agreement

(a) The concern

Defendants have an interest in knowing the extent of the involvement of a funder in litigation. This is likely to have a bearing on a defendant's litigation strategy and will inform many of its decisions. The knowledge that a litigation funder has been engaged might, for example, impact upon a defendant's decision to apply for security for costs, as well as on the court's decision in making any order for adverse costs. Knowledge that a wealthy, reputable, and (presumably) prudent funder has decided to

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16 PrincewaterouseCoopers v Walker [2017] NZSC 151, [2018] 1 NZLR 735, at [15], citing *Stevens v Keogh* (1946) 72 CLR 1, (1946) 20 ALJR 161 (HCA), at 28 per Dixon J.

17 Jason Lyon, Revolution in Progress: *Third-Party Funding of American Litigation* UCLS Law Revue 58 (2010): 571-609, at 576.

18 High Court Rules 2016, r 15.1; District Court Rules 2014, r 15.1; the inherent powers of the Supreme Court to stay proceedings for abuse of process, for which see *Waterhouse v Contractors Bonding Ltd* [2013] NZSC 89, [2014] 1 NZLR at [30].

19 Broadly, it seems TPLF may be captured by general consumer protection legislation, credit and financial services legislation, and financial services provider legislation. However, there has been no determinative court ruling to confirm their application to TPLF services.

support a claim might bring upon the defendant additional incentive to settle and avoid the time and expense of lengthy proceedings.

On the other hand, it is not inconceivable that a hidden litigation funder might adopt a "whatever it takes" strategy, exhausting every procedurally available option and drastically increasing litigation expenses. This is more than just a hypothetical. In a rather extreme example in Florida in 2016, Terry Gene Bollea sued Gawker Media LLC for invasion of privacy, infringement of personality rights, and intentional infliction of emotional distress, after publishing a sex tape of Boella with the wife of a close friend.[20] In March 2016, a jury awarded Boella $140 million in damages. What the defendant, jury, and public did not know, however, was that the suit had been secretly funded by PayPal co-founder and billionaire, Peter Thiel, vindicating a personal vendetta against Gawker for outing him as gay in an article in 2007.[21] Boella, aided by Thiel's significant capital, overwhelmed Gawker's legal team. Three months later, Gawker filed for bankruptcy. Thiel only revealed his involvement after judgment had been given.[22]

With this case in mind, it might reasonably be argued that the ability for a non-party to secretly exercise a personal agenda in funding litigation is simply further evidence that TPLF exposes the legal system to abuse. While there are few examples of TPLF being used to exact a personal agenda, it has been argued that it can reasonably be inferred that the phenomenon is more common than currently understood.[23] However, that is not what *Boella* illustrates. Disparity in resources is already a reality. It is not uncommon for even defendants – aware of the financial pressures burdening a struggling, unsupported plaintiff – to prolong proceedings with frivolous claims or extensive discovery. What the above example *does* illustrate, however, is that some form of regulation relating to mandatory disclosure of a funding agreement is needed.

(b) The legal position in New Zealand

The current position on the disclosure of a funding agreement in New Zealand is set out in *Waterhouse v Contractors Bonding* [2013] NZSC 89, [2014] 1 NZLR 91 (***Waterhouse***). The Supreme Court held that the existence of a litigation funder, the funder's identity, and the funder's amenability to domestic courts, should always be disclosed when litigation is commenced.[24] The existence of a funder was held to be relevant to the defendant for applications as to adverse costs and security for costs, and applications for a stay of proceedings on grounds of abuse of process.[25] The Court, however, stopped short at mandating disclosure of both the financial means of the funder and the terms of the agreement, which could confer a tactical advantage on the defendants.[26] It was left open that disclosure of the terms upon which funding could be withdrawn might be disclosed if an application for security for costs were made by the defendant.[27] Ultimately, of importance to the Court was the idea that both the court and all parties involved are entitled to know the identity of all *"real parties"* to the litigation.[28]

This approach is not without issue – it rests upon a relatively tenuous extension of well-established common law principles of disclosure. In all instances, the touchstone of disclosure is the question of relevance to a matter in question in the proceedings, for which the court must always have reference to the pleadings.[29] However, costs are not a matter for pleadings; the assessment of costs comes

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[20] *Boella v Gawker Media LLC* No 12012447CI-011, 2016 WL 4073660 (Florida Circuit Court, 8 June 2016).

[21] Owen Thomas, "Peter Thiel is Totally Gay, People" *Gawker* (19 December 2007): available at https://www.gawker.com/335894/peter-thiel-is-totally-gay-people (accessed 22 March 2023).

[22] Andrew Ross Sorkin, "Pete Thiel, Tech Billionaire, Reveals Secret War with Gawker" *New York Times* (25 May 2016): available at https://www.nytimes.com/2016/05/26/business/dealbook/peter-thiel-tech-billionaire-reveals-secret-war-with-gawker.html (accessed 22 March 2023).

[23] Lili Levi, "The Weaponised Lawsuit Against the Media: Litigation Funding as a New Threat to Journalism" *American University Law Review* 66 (2017): 761-828, at 769 and 779-83.

[24] *Waterhouse v Contractors Bonding* [2013] NZSC 89, [2014] 1 NZLR 91, at [67]-[71], [76].

[25] *Waterhouse v Contractors Bonding* [2013] NZSC 89, [2014] 1 NZLR 91, at [63], [67].

[26] *Waterhouse v Contractors Bonding* [2013] NZSC 89, [2014] 1 NZLR 91, at [71].

[27] *Waterhouse v Contractors Bonding* [2013] NZSC 89, [2014] 1 NZLR 91, at [72]. In this instance, security for costs was voluntarily provided, so the court did not need to decide on the issue.

[28] *Waterhouse v Contractors Bonding* [2013] NZSC 89, [2014] 1 NZLR 91, at [68].

[29] See *Chatfield & Co Ltd v Commissioner of Inland Revenue* [2016] NZCA 614, (2016) 27 NZTC 22-084, at [21]; *New Zealand Rail Ltd v Port Marlborough New Zealand Ltd* [1993] 2 NZLR 641 (CA); *Body Corporate 187241 v Auckland City Council* CIV-2005-404-001597, 20 July 2006 at [20].

after the conclusion of the substantive proceeding. The High Court has already held, in the context of an application to strike out, that there is no general right to obtain the name of an insurer from a defendant in proceedings and has declined discovery of a defendant's insurance arrangements because it was not relevant to the relevant pleadings.[30] The position of an insurer is not dissimilar to TPLF. The somewhat tenuous common law basis for the court's actions regarding disclosure of a funding agreement means that pro-active regulation is required. For this, reference should be had to Australia – specifically, New South Wales.

(c) International regulation

Formal regulation mandating the disclosure of a funding agreement was introduced in Australia in 2010 following more than a decade of unregulated judicial oversight. Practice notes adopted by the Federal Court and the Supreme Court of Victoria, in 2011 and 2010 respectively, mandate disclosure of agreements by which a non-party is to pay for or contribute to the costs of a proceeding.[31] The effect of this is that *"[a]t or prior to the initial case management conference each party will be expected to disclose any agreement by which a litigation funder is to pay or contribute to the costs of the proceeding, any security for costs or any adverse costs order"*.[32] It does, however, specifically permit the redaction of information that might reasonably confer a tactical advantage on the other party – a concern shared by the Supreme Court in *Waterhouse*.[33]

What is interesting is that support for disclosure is mirrored in public opinion. IMF (Australia) Limited (**IMF**), the largest commercial litigation funder in Australia, for example, advocates for the full, public, and mandatory disclosure of funding agreements. In June 2011, it made formal submissions to the New South Wales Law Reform Commission supporting the enactment of regulations requiring disclosure at the initial case management conference.[34] In Canada, even in the absence of regulation, judges appear intent on crafting guidelines favouring transparency and even rules requiring court approval of agreements.[35]

(d) Suggestion for regulation in New Zealand

In New Zealand, Parliament must enact formal regulation mandating the disclosure of a funding agreement. This would provide greater certainty for all parties involved – especially defendants. Returning to the example of *Boella v Gawker*, it is reasonable to suggest that the dynamics of the proceeding would have been different had Thiel's involvement been disclosed earlier. It might have pushed Gawker to settle or move to secure non-party funding of its own; it might even have flipped the jury's perception of who the proverbial "David" and "Goliath" was, influencing the outcome of their decision.[36] There are those who equally claim that the involvement of a funder – disclosed or not – had little impact on the outcome of the case.[37] There is no way to know if that is correct. However, it assumes that the merits of a claim alone are decisive in the outcome of litigation – which is rarely, if ever, the case.

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[30] *Body Corporate 187242 v Auckland City Council* CIV-2005-404-001597, 20 July 2006, at [40], [47].

[31] Practice Note CM 17 (2011): *Representative Proceedings Commenced under Part IVA of the Federal Court of Australia Act 1976*; for the Supreme Court of Victoria, see Practice Note No, 9 (2010): *Conduct of Group Proceedings.*

[32] Practice Note CM 17 (2011): *Representative Proceedings Commenced under Part IVA of the Federal Court of Australia Act 1976*, cl. 3.6; Practice Note No. 9 (2010): *Conduct of Group Proceedings,* cl. 3.6.

[33] Class Action Practice Note 2016 (GPN-CA) commenced under Part IVA of the Federal Court of Australia Act 1976, cl. 6.4(b): available at https://www.fedcourt.gov.au/law-and-practice/practice-documents/practice-notes/gpn-ca (accessed 28 March 2023); see also *Waterhouse v Contractors Bonding* [2013] NZSC 89, [2014] 1 NZLR 91, at [72].

[34] Jasminka Kalajdzic, Peter Cashman, Alana Longmore, "Justice for Profit: A Comparative Analysis of Australian, Canadian and U.S. Third Party Litigation Funding," *The American Journal of Comparative Law* 61, No. 1 (2013): 93-148, at 123.

[35] asminka Kalajdzic, Peter Cashman, Alana Longmore, "Justice for Profit: A Comparative Analysis of Australian, Canadian and U.S. Third Party Litigation Funding," *The American Journal of Comparative Law* 61, No. 1 (2013): 93-148, at 140.

[36] Rebecca Leinen, "Striking the Right Balance: Disclosure of Third-Party Funding," *Oxford University Commonwealth Law Journal* 20, No. 1 (2020): 115-138, at 123.

[37] Andrew Ross Sorkin, "Pete Thiel, Tech Billionaire, Reveals Secret War with Gawker" *New York Times* (25 May 2016): available at https://www.nytimes.com/2016/05/26/business/dealbook/peter-thiel-tech-billionaire-reveals-secret-war-with-gawker.html (accessed 22 March 2023).

Under the assumption that regulation is needed, it is suggested that this should be implemented by way of an amendment to the High Court Rules 2016. The amendment should mandate the disclosure of an appropriately redacted funding agreement in any instance in which a funder is to pay for or benefit from of a proceeding. This suggestion already has a relatively analogous comparison in New Zealand. In 2018, the Rules Committee suggested a draft rule that required a plaintiff to include in any affidavit in support of an application for a representative order whether their claim is funded by a non-party.[38] It would not be difficult to replicate this in the context of, for example, Schedule 5 of the High Court Rules 2016.

(4) Security for Costs and the Recovery of Adverse Costs by a Defendant

(a) The concern

In New Zealand, adverse costs may be awarded whereby the unsuccessful party to a litigation pays some or all of the successful party's legal costs. The purpose of this is to deter the commencement of frivolous litigation and encourage settlement. The risk of paying a portion of the defendant's legal costs is meant to act as a financial disincentive.[39] The concern of a defendant in relation to this is simple. If the plaintiff requires the financial assistance of a third party to cover their own legal costs, it is a logical corollary that they will require the same assistance in paying any adverse costs. Therefore, the question of the extent to which the court can award costs directly against the litigation funder is important.

(b) The legal position in New Zealand

It is possible for a funder to contractually assume the risk of paying adverse costs by providing the plaintiff with an indemnity. If the funder were to not comply with the agreement, the defendant could simply bring a claim for breach of contract. This assumption of risk is obviously voluntary, but in instances in which the funding agreement does not allocate risk, it is well established that the courts have the discretion to make a non-party costs order – including against a litigation funder.[40] This discretion has been readily exercised in the past.[41] The Privy Council in *Dymocks Franchise Systems NSW Party Ltd v Todd (No 2)* [2004] UKPC 39, [2005] 1 NZLR 145 (***Dymocks***) held that funders will be liable for an adverse costs order if litigation would not have been undertaken without their involvement, and if they not only fund the proceedings but sufficiently control or benefit from them.[42] This is because, for all intents and purposes, the funder is a "real party" to the litigation.[43] The ability to award adverse costs against a litigation funder in New Zealand, therefore, is extremely well founded. The same is broadly true of security for costs.

The presence of a litigation funder does not complicate the regime regulating security for costs. If an order for security for costs is made against a plaintiff, it is up to the plaintiff and funder to negotiate how this is paid; it is of no concern to a defendant *how* security for costs is financed, just that it ultimately is. Therefore, as discussed below, of concern is not whether costs *can* be awarded, but how *much* can be.

(c) International regulation

To allow costs against non-parties is not an approach unique to New Zealand. The High Court of Australia in *Jefferey and Katauskas Party Limited v Rickard Construction Party Limited* (2009) 239

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[38] The Rules Committee, Minutes of meeting held on 26 February 2018, at 2: available at: https://www.courtsofnz.govt.nz/about-the-judiciary/rules-committee/meetings/ (accessed 9 March 2023).

[39] Michael Legg & Louisa Travers, "Necessity is the Mother of Invention: The Adoption of Third-Party Litigation Funding and the Closed Class in Australian Class Actions", Common Law World Revue 38, No. 3 (2009): 245-267, at 253; cit. Michael Legg, Edmond Park, Nicholas Turner, and Louisa Travers, "The Rise and Regulation of Litigation Funding in Australia," *Northern Kentucky Law Review* 38, No. 4 (2011): 625-672, at 630.

[40] *Dymocks Franchise Systems NSW Party Ltd v Todd (No 2)* [2004] UKPC 39, [2005] 1 NZLR 145; *Carborundum Abrasives Limited v Bank of New Zealand Limited* (No 2) [1992] 3 NZLR 757.

[41] *Waterhouse v Contractors Bonding* [2013] NZSC 89, [2014] 1 NZLR 91, at [64]; *S H Lock (NZ) Ltd v New Zealand Bloodstock Leasing Ltd* [2011] NZCA 675, at [14]-[16]; see also *Dymocks Franchise Systems NSW Party Ltd v Todd (No 2)* [2004] UKPC 39, [2005] 1 NZLR 145.

[42] *Dymocks Franchise Systems NSW Party Ltd v Todd (No 2)* [2004] UKPC 39, [2005] 1 NZLR 145, at [25(3)].

[43] *Dymocks Franchise Systems NSW Party Ltd v Todd (No 2)* [2004] UKPC 39, [2005] 1 NZLR 145, at [25(3)].

CLR 75 also referred to the need to consider the principles governing costs to address *"the manner in which the risks and burdens of litigation are borne by defendants"*.[44] Traditionally, rule 42.3 of the Uniform Civil Procedure Rules 2005 (NSW) precluded a defendant from seeking a costs order against a non-party where a funder did not indemnify the plaintiff against the defendant's costs.[45] This was the case but for specific and limited circumstances, such as abuse of process.[46] However, on 7 May 2010, this rule was repealed and the discretion of the courts of New South Wales under section 98 of the Civil Procedure Act 2005 was unfettered in the exercise of discretion in making a costs order against a non-party – including a litigation funder. Similarly in all other states, courts have jurisdiction to make costs orders against non-parties where the interests of justice allow a departure from the general rule that only parties to proceedings may be subject to costs.[47]

The same is true of security for costs in England and Wales.[48] In *Wall v Royal Bank of Scotland* [2016] EWHC 2460, the court even held that an order for the disclosure of the name and address of a litigation funder could be made to satisfy the defendant's procedural right for a costs order to be made against a non-party.[49]

The real issue, therefore, is deciding quantum in the context of adverse costs. This issue has not received much judicial attention in New Zealand. It is, perhaps for obvious reasons, preferable to defendants that funders be liable for as much of the potential sum as possible. This is true for plaintiffs too; if a funder makes proceedings possible and stands to gain from its success, it is only right that they shoulder the risk. However, the issue is not that simple.

The liability of a funder for adverse costs is provided for under the common law. In England and Wales, the so-called "*Arkin* cap" limits the liability of a funder to costs equivalent to the amount provided to the plaintiff.[50] For example, if a funder were to cover the plaintiff's expert evidence and the cost of discovery, then the sum of that would be the extent of its liability for costs. The *Arkin* cap was formulated in the context of limited funding by the non-party, but the court proposed that there was no reason for the cap not to be applicable where a funder has contributed to most, or even all the plaintiff's expenses.[51] The rationale for keeping costs capped in this manner is to strike a balance between encouraging access to justice and the need for successful defendants (who had no choice but to litigate) to recover their costs.[52] There is merit to this approach. The approximation of liability means a funder has certainty in its exposure and the cap disincentivises frivolous litigation far beyond the means of the plaintiff by binding adverse costs to financial engagement.

(d) Suggestion for regulation in New Zealand

For defendants (and even plaintiffs), the ideal scenario is one in which quantum is assessed without reference to a general cap. For defendants, capping a funder's liability for adverse costs heightens the risk of unrecovered costs. In any event, the two-thirds cost recovery scheme that operates in New Zealand means that the costs a defendant is likely to recover will be less than the amount a funder has committed to the litigation in the first place. To have no cap whatsoever, however, might swing too far away from encouraging funding to promote access to justice. For this reason, the best method of calculating quantum might be by reference to a proportionality cap – in other words, if a funder were to finance 75 percent of the plaintiff's costs, then it should be exposed to 75 percent of the adverse costs awarded by the court. This would accord nicely with the Privy Council's logic in *Dymocks*, by which the more a funder controls and benefits from a proceeding, the greater the adverse costs to which it should be exposed.[53] It might be difficult in practice for courts to assess proportionality; funding agreements do not usually commit funders to finance a percentage of costs. This means that the extent of the funder's liability should remain a matter of discretion for the court,

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[44] *Jefferey and Katauskas Party Limited v Rickard Construction Party Limited* (2009) 239 CLR 75 at 39 and 97.
[45] Uniform Civil Procedure Rules (Amendment No, 32) 2010 (NSW).
[46] *Jefferey and Katauskas Party Limited v Rickard Construction Party Limited* (2009) 239 CLR 75, at 85-86.
[47] Michael Legg, Edmond Park, Nicholas Turner, and Louisa Travers, "The Rise and Regulation of Litigation Funding in Australia," *Northern Kentucky Law Review* 38, No. 4 (2011): 625-672, at 647.
[48] Criminal Procedure Rules 2020 (UK), r. 25.14(2)(b).
[49] *Wall v Royal Bank of Scotland Plc* [2016] EWHC 2460 (Comm).
[50] *Arkin v Borchard Lines Limited* [2005] EWCA Civ 655, [2005] 1 WLR 3055.
[51] *Arkin v Borchard Lines Limited* [2005] EWCA Civ 655, [2005] 1 WLR 3055, at [43].
[52] A*rkin v Borchard Lines Limited* [2005] EWCA Civ 655, [2005] 1 WLR 3055, at [42].
[53] *Dymocks Franchise Systems NSW Party Ltd v Todd (No. 2)* [2004] UKPC 39, [2005] 1 NZLR 145, at [25(3)].

where it can be assessed by reference to each individual case.[54] In addition, the disclosure of agreements might aid the court in determining what specific costs have been financed. Ultimately, costs should be a matter of discretion for the courts, assessed on the basis of individual cases as and when they arise, with reference to a proportionality cap.

(5) Mandatory Capital Adequacy Requirements

(a) The concern

The promise to fund the costs of litigation and meet all adverse costs orders might become largely illusory if it turns out that said funder lacks the adequate capital or insurance. Litigation funding is expensive, and it is not outside the realm of possibility that a funder is unable to cover its costs. If this were to happen, an embattled defendant, who had no choice but to defend what might be very expensive litigation, might find that they have won a pyrrhic victory in which their costs cannot be recovered. In addition, the lack of regulation or adequate oversight may attract overseas funders, beyond the jurisdiction of New Zealand's courts, when they find that they can litigate a claim for profit but avoid costs if unsuccessful. In general, therefore, the idea behind capital adequacy requirements is that there should be a mandatory level of capital that a funder is required to maintain, regulated through a licencing system, and monitored by an independent and accountable financial regulator.

(b) The legal position in New Zealand

Regulation pertaining to capital adequacy for funders in New Zealand is virtually non-existent. Insurers and banks are subject and accountable to reserve requirements.[55] However, there is currently no such regulation or licencing system for litigation funders.

(c) International regulation

In England and Wales, the voluntary Association of Litigation Funders Code of Conduct (**ALF Code**) imposes an obligation on funders to maintain adequate financial resources at all times in order to meet obligations to fund all disputes they have agreed to.[56] In addition, rule 3.15.3 requires funders to be audited annually and to provide the ALF with a copy of this audit with additional evidence that it satisfies the minimum capital requirement.[57] The obvious limitation of this regime is that it is voluntary. Rachael Mulleron, a professor of tort law and civil justice at Queen Mary University of London, noted in a study in 2014 that only seven of the sixteen recognised litigation funders then operating in England and Wales subscribed to the ALF Code.[58] This has increased to twenty-two funders as of the writing of this essay,[59] but there is no saying how many litigation funders are currently operating.

In Hong Kong SAR, a code of practice regulating TPLF was introduced on 1 February 2019. This code was enacted to tackle a number of procedural risks associated with TPLF, including the risk of insufficient capital capacity of funders.[60] In Article 2.5 of this code, a funder is required to *"pay all debts when they become due and payable and cover all of its aggregate funding liabilities under all of*

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54 This is also suggested in Sir Rupert Jackson, *Review of Civil Litigation Costs: Final Report* (Ministry of Justice, United Kingdom, 2010), at 123, available at: https://www.judiciary.uk/wp-content/uploads/JCO/Documents/Reports/jackson-final-report-140110.pdf (accessed 19 March 2023).

55 Minimum capital ratios are imposed by the Reserve Bank of New Zealand, pursuant to its powers to register and supervise banks under Part 5 of the Reserve Bank of New Zealand Act 1989; and the Insurance (Prudential Supervision) Act 20210 and the Non-Bank Deposit Takers Act 2013 are administered by the Reserve Bank.

56 Association of Litigation Funders Code of Conduct for Litigation Funders, cl. 9.4.1 – 9.4.3 and 9.4.4.1, available at: https://associationoflitigationfunders.com/wp-content/uploads/2018/03/Code-Of-Conduct-for-Litigation-Funders-at-Jan-2018-FINAL.pdf (accessed 17 March 2023).

57 The Association of Litigation Funders of England and Wales, "Rules of the Association" (2018), r. 13.5.3.

58 Rachael Muleron, "England's Unique Approach to the Self-Regulation of Third Party Funding: A Critical Analysis of Recent Developments" *The Cambridge Law Journal* 73, No. 3 (2014): 570-597, at 578.

59 A list of current members can be found at https://www.associationoflitigationfunders.com/membership/membership-directory/ (accessed 29 March 2023)

60 Beibei Zhang, *Third Party Funding For Dispute Resolution: A Comparative Study of England, Hong Kong, Singapore, the Netherlands, and Mainland China* (Springer: Singapore, 2021) at 73.

its funding agreements".[61] To do so, funders must maintain access to a minimum of HKD $20 million of capital.[62]

There are currently no mandatory capital adequacy requirements for litigation funders in Australia, but a number of moves towards a licencing regime that involves requirements to maintain adequate capital have been attempted. In 2011, IMF made a formal submission to the New South Wales Law Reform Commission supporting the enactment of mandatory regulations imposing adequate capital requirements – though this has yet to be taken up.[63]

(d) Suggestion for regulation in New Zealand

The imposition of capital adequacy requirements for litigation funders is needed. The complex nature of high-value litigation funded by non-parties means that interruption due to the inadequate capital of the funder will have a hugely disrupting impact on the defendant. It will prolong proceedings, cost more money, deepen animosity between the parties, and further delay any nascent project in the meantime. It is clear that every international jurisdiction referenced above has needed to retroactively grapple with fact that the financial requirements of litigation funders in the law do not reflect the financial exposure of a funder in a proceeding. New Zealand needs to deal with this issue before these issues emerge.

Formal regulation (ameliorated by security for costs orders in certain circumstances) is the most desirable solution. If all litigation funders were to be subject to a licencing regime, they would be subject to prudential regulation, certification, and audit requirements. This could be monitored by an independent body separate from the industry – perhaps the Reserve Bank of New Zealand. In the absence of a licensing regime, litigation funders could be subscribe to a code of conduct in the same manner as in England and Wales. In either case, this would require determining what the minimum level of capital should be.

Imposing capital adequacy requirements will ensure that only funders capable of maintaining litigation will be able to do so. The implementation of capital adequacy requirements on funders may even partially satisfy a defendant's desire to have security for costs posted when facing funded plaintiffs. There are valid concerns that such requirements will make TPLF less accessible and deter new entrants to the market, but any impact of this nature is preferable in the face of what might happen without it.

(6) Conclusion – The Future of Regulation of TPLF in New Zealand

TPLF is a civic good that increases access to justice and vindicates of the rights of those with meritorious claims – a privilege that belongs to those who can afford it. However, legislative and administrative reform is needed in order to mitigate its potential for abuse. For the construction sector, this concern is particularly acute from the perspective of a defendant to civil litigation. As per the New South Wales Court of Appeal in *Hall v Poolman* [2009] NSWCA 64, *"[t]he facts of this case … [show] how a mammoth piece of litigation can be instigated, perhaps to the ruin of a defendant, with negligible "access to justice" for those who have suffered a wrong but with lucrative reward for those who make a business of investing in law suits"*.[64] This essay has examined three of the most pressing concerns facing defendants and has concluded that regulatory reform and oversight is needed. Funding agreements (redacted to protect privileged matters or that which might confer a tactical advantage) should be disclosed to the court and defendant. This will ensure defendants make informed choices regarding security for costs and stay of proceedings on abuse of process grounds. Further, courts should be given the express power to order costs directly against the litigation funder. The sum of costs should be left to the discretion of the court, subject to a proportionality cap to balance fairness to the defendant with certainty for the funder. Finally, mandatory capital adequacy requirements should be implemented, preferably through a licencing system or a formal code of

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[61] Department of Justice, Draft Code of Practice for Third Party Funding of Arbitration and Mediation (2018), 2.5.

[62] Beibei Zhang, *Third Party Funding For Dispute Resolution: A Comparative Study of England, Hong Kong, Singapore, the Netherlands, and Mainland China* (Springer: Singapore, 2021), at 81.

[63] Jasminka Kalajdzic, Peter Cashman, Alana Longmore, "Justice for Profit: A Comparative Analysis of Australian, Canadian and U.S. Third Party Litigation Funding," *The American Journal of Comparative Law* 61, No. 1 (2013): 93-148, at 123.

[64] *Hall v Poolman* [2009] NSWCA 64, at 38.

conduct. TPLF is the new reality in high-value litigation, and New Zealand needs to begin regulating it before these concerns manifest as very real problems.

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