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LEGAL UPDATE

Let the litigation funder beware

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Litigation funding agreement

A litigation funding agreement is an agreement that provides for a non-party to finance a legal action on behalf of a litigant in return for a share of the proceeds of the action. Before 2004, the validity of litigation funding agreements in South African law was anything but clear.

Jurisprudence was dominated by the historical English-law distaste for champerty (supporting someone else's litigation in exchange for a share in the proceeds) and maintenance (supporting someone else's litigation without any entitlement to a share in the proceeds), and by the Roman-Dutch principles governing *pacta de quota litis*.

The pre-2004 South African position, in summary, was that a litigation funding agreement was lawful provided that it was concluded in good faith and provided that it was not contrary to public policy. It would be contrary to public policy if it was of a "speculative nature", or concluded for a "wrongful purpose". The obvious vagueness of these terms would have provided few useful guidelines to anyone considering a litigation funding arrangement; but the general attitude of the South Africans to champertous agreements pre-2004 can be inferred from the fact that such agreements were held to be contrary to public policy, and therefore unenforceable, more often than not.

The landscape changed with the judgment of the SCA in *PricewaterhouseCoopers Inc v National Potato Cooperative Ltd*[1], which cast aside the uncertainty by holding that a litigation funding agreement is not contrary to public policy or void. Giving decisive importance to the constitutional imperative of access to justice in determining public policy on the issue, the court opined that *"...the need for the rules [against] maintenance and champerty has diminished – if not entirely disappeared"*. The courts retain the power to prevent litigation funding if it amounts to an abuse of process, but this is no different from the courts' power to deal with any other kind of abuse of process.

With this judgment, the game was on for the entry of commercial litigation funders – equity funds, investment houses, merchant banks and the like – into the South African market. And the last few years have indeed seen an increase in litigation funding activity in South Africa, as foreign investors, already a long-standing feature of the dispute resolution landscape in the UK, USA, Australia and elsewhere, seek out returns that cannot be matched by conventional markets. In addition, home-grown funding initiatives are starting to occur, with South Africa's first dedicated litigation funding company reportedly commencing business in 2013.[2]

Validity of litigation funding agreements

Two recent reported judgments – one from the North Gauteng High Court (NGHC) and the other from the Western Cape High Court (WCHC) – have grappled with the question of a litigation funder's potential liability for the costs of the funded proceedings. In both cases, the courts' rulings may give potential litigation funders pause for thought.

In *PricewaterhouseCoopers Inc v IMF (Australia) Ltd and Another*[3], the NGHC granted relief to the defendant in funded proceedings in the form of an order joining the funder to the litigation as a co-plaintiff, against its will, so that the defendant could seek a costs order directly against the funder. Noting that it is already possible to obtain directs costs orders *de bonis propriis* against certain categories of non-party such as legal representatives and public officials, the court held that allowing a defendant in funded proceedings to join the funder as a co-plaintiff would be a "logical progression" from the landmark 2004 decision that champertous agreements are not unlawful.

The court added that the ability to hold funders directly liable for costs could be one of the measures at the court's disposal to counter any possible abuses arising from its recognition of the validity of litigation funding agreements – a possibility recognised by the SCA in its 2004

ruling.

Frustratingly, however, the court made little attempt to clarify the parameters of its development of the common law on this point. It did not express a view on whether the defendant in funded proceedings is now entitled as of right to join the funder as a co-plaintiff so as to be able to seek a costs order against it, or whether this relief will only be granted to the defendant in certain circumstances – and if so, what those circumstances are and what considerations will come into play in determining the matter.

The defendant is entitled to join the funder as a party to the proceedings

The court seems to have intended to develop the common law such that it is now the default position that the defendant is entitled to join the funder as a party to the proceedings; but again, the court did not say what considerations might be relevant in persuading the court to deviate from the default position and refuse a joinder. The court, not being called upon to make a costs order *in casu* but merely to rule on a joinder application, also did not lay down any guiding principles in relation to when and in what circumstances it would actually hold a litigation funder liable for costs, or whether the default position will be that the funder is liable.

In *EP Property Projects (Pty) Ltd v Registrar of Deeds, Cape Town, and Another, and four related applications*[4], the court exercised its discretion to grant a costs order against a litigation funder who had already been joined to the proceedings. The court canvassed the position under English law and in other common-law jurisdictions, noting that costs orders would generally not be granted against "pure funders", i.e. funders who do not seek to control the course of the litigation or derive any benefit from it, and who therefore lack any personal interest in it.

But where the funder substantially controls the proceedings or will benefit from them, if successful – both of which factors are invariably present in the case of commercial litigation funding, which is, after all, a form of investment – then the funder is not so much facilitating access to justice as gaining access to it for his own purposes, and becomes the "real" party to the litigation in all but name. It is then considered just that he be held liable for any adverse costs order occasioned by his enterprise.

The court then held that there is no reason why the South African law should not be that a non-party funder could be potentially liable, in the exercise of the court's discretion, for an adverse costs order made against the funded party. The facts of the case made it fairly easy for the court to exercise its discretion *in casu*: the funder was in full control of the litigation; she stood to benefit financially if successful, in terms of her funding agreement; and in addition, it was clear that the funded party had acted fraudulently and in bad faith, and that the funder was aware of that at the time of concluding the funding agreement. By funding and controlling the proceedings, the funder had associated herself with the fraudulent and *mala fide* conduct of the funded party.

Curiously, the court added one more reason in favour of exercising its discretion against the funder; namely that she was not a commercial funder of litigation who funded litigation as part of her business affairs. Therefore, so the court reasoned, the chilling effect of a potential adverse costs order, which could perhaps stifle commercial third-party funding and thus inhibit access to justice for indigent litigants, did not apply to her. This reasoning is difficult to understand, as there does not appear to be any moral difference between an individual funding a single action for financial gain, and a corporation funding multiple actions for financial gain. In both instances, the funder is making a calculated investment with the hope of a return.

The court surely did not intend to suggest that the *mala fide* conduct of the funder *in casu* would have been tolerated if the funder had been a dedicated litigation-funding corporation rather than an individual making an opportunistic investment.

It seems, rather, that the court was cognisant of the effect that its ruling could have on the nascent litigation funding sector in South Africa, with collateral damage to the constitutional imperative towards access to justice, and was anxious to reassure potential funders that they would not be held liable for adverse costs order granted against funded litigants simply as a matter of course.

Individual dilettante funder and the corporate dedicated funder

It is my view that the distinction between the individual dilettante funder and the corporate dedicated funder, as a factor in exercising discretion to award costs, will not be taken up by other courts and would not survive scrutiny by the SCA or the Constitutional Court. It will nevertheless be interesting to see how the courts exercise their discretion to award costs against litigation funders in future. Specifically, will the courts readily grant adverse costs orders directly against corporate litigation funders in cases where no element of *mala fides* or fraudulent conduct is present – which will constitute the vast majority of cases that come before the courts?

Many corporate litigation funding agreements in any event provide for the funder to satisfy any adverse costs order granted against the funded litigant; however, that is not the same thing as being joined as a party to the proceedings and being subjected directly to an enforceable costs order. Litigation funders may find the latter situation somewhat less palatable, and this will certainly be a factor to be taken into account by prospective funders when performing preliminary case analyses prior to concluding funding agreements. One thing seems clear: with the rise of litigation funding in South Africa, it will probably not be long before the courts have the opportunity to further develop the law on this point.

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[1] 2004 (6) SA 66 (SCA)

[2] 'Litigation funder to help out 'man in the street'', Roy Cokayne, *Pretoria News*, 3 June 2013

[3] 2013 (6) SA 216 (GNP)

[4] 2014 (1) SA 141 (WCC)

@werksmans