November 2014

# BRIEFING NOTE

**Court of Appeal Shuts Door on Litigation Financing Interest as a taxable disbursement in British Columbia – *MacKenzie* v. *Rogalasky*, 2014 BCCA 446**

Litigation funding has been the subject of much discussion in legal circles over the last few years. Until now the dialogue has centred around whether it was required to ensure access to justice as the costs relating to the conduct of lawsuits have inflated so much as to become prohibitive for many would-be litigants.

Nonetheless, the B.C. Court of Appeal has held that out-of-pocket interest payments incurred to finance disbursements are not recoverable by successful parties. The Court's conclusion reframes the legal debate concerning this subject by focusing on the wording of Rule 14-1(5) while noting that the costs regime was never intended to provide perfect indemnification.

**Facts**

The decision addressed two appeals.

In *Chandi* v. *Atwell*, 2011 BCSC 1498, the plaintiff had borrowed money from his lawyers and a third party lender to fund disbursements in his personal injury action. The plaintiff's parents were also injured in the same motor vehicle and were left in dire circumstances. Mr. Chandi sought to recover $25,688.92 in interest on the third-party loan, which had accrued at 12% compounded annually.

In *MacKenzie* v. *Rogalasky*, 2012 BCSC 156, Mr. MacKenzie borrowed money from a third-party financier after being injured in a motor vehicle accident. An expert was required to establish that Mr. MacKenzie was suffering from chronic pain. His only source of funding was a loan from a specialized litigation lender. Mr. MacKenzie did not qualify for a bank loan; his credit cards were maxed out; and he had already borrowed from his family. Mr. MacKenzie sought $11,324.71 in interest on a loan with principal sum of $25,000, plus a $1,250 underwriting fee. Interest in his case accrued at a rate of 26.82% annually.

**At Issue**

The issue arising in both appeals was whether out-of-pocket interest incurred by the successful litigant as an expense in funding disbursements is recoverable as a disbursement under Rule 14-1(5) of the B.C. *Supreme Court Civil Rules.*

Rule 14-1(5) authorizes a registrar to award a "reasonable amount" for disbursements "necessarily or properly incurred in the conduct of the proceeding".

**Judicial Background Prior to the Decision**

Financing litigation on borrowed funds has been a controversial topic for some time. The practice has been more readily recognized as a potential necessity. This is particularly true where plaintiffs may otherwise have been denied access to justice.

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The first appellate-level decision on interest as a recoverable disbursement was rendered in *LeBlanc* v. *Doucet*, 2012 NBCA 88. The 17-year-old plaintiff in that case relied on a loan from an independent funder to cover his litigation expenses. The rate of interest accrued at a steep 32.9% annually. The New Brunswick Court was unanimous in allowing interest on Mr. LeBlanc's financing to be recovered as a disbursement. The *LeBlanc* decision expressly recognized for the "necessity" of such funding to override their *Rules of Court*, which do not make express allowance for such a recovery. A similar ruling was made at trial in in *Herbert* v. *Brantford (City)*, 2010 ONSC 6528 and was arguably upheld by the Ontario Court of Appeal 2012 ONCA 98. This accommodation for the circumstances of the plaintiff puts the New Brunswick and Ontario law on this issue in direct opposition to that in BC.

Prior to this decision, the B.C. case law had been influenced by *Milne* v. *Clarke* 2010 BCSC 317 regarding whether interest can be charged as a disbursement. In *Milne*, the B.C. Supreme Court focused on the question of necessity and ruled that interest owing as a result of a party's inability to pay for appropriate disbursements was recoverable. In *Milne*, the dispute arose over interest charges on MRI scan invoices. The Supreme Court refrained from providing an answer on the issue definitively, choosing instead to await a case with the "proper factual matrix". Such circumstances arose in *Chandi*, where the Supreme Court applied *Milne*. A number of cases thereafter followed closely on the Supreme Court's *Chandi* ruling, and each turned on whether the plaintiff had established the necessity for the funding and the propriety of the interest rates for each.

Leading up to the *MacKenzie* appeal, there had been an emerging recognition of policy reasons to justify out-of-pocket interest as a recoverable disbursement. As Master Young stated in *Krenn* v. *ICBC*, 2013 BCSC 810, there is a compelling argument that there is a growing "impoverished middle-class" who cannot fund lawsuits up front and do not qualify for legal aid and hence will be denied justice without this financing (at para 36).

The B.C. Law Society seems to have recognized the growing trend of litigation funding. In a recent Bencher's Bulletin, the Ethics Committee provided guidance to lawyers who advance funds to clients to cover disbursements and other costs, such as medical and living expenses (at pg. 12). The Committee advised that lawyers disclose interest charges in writing, ensure charges are fair and reasonable, and ensure client consent.

**The Court's Decision**

The Court's decision was based on three rationales: first, the interpretation of Rule 14-1(5); second, the purposes of the costs regime; and third, the "general legal environment governing the recovery of pre-judgment interest" under the *Court Order Interest Act* [*COIA*].

**Interpreting Rule 14-1(5)**

Justice Harris begins the Court's analysis by noting that the right to costs, including disbursements, was not recognized in common law. Rather, rules regarding the recovery of disbursements are creatures of statute that must be interpreted according to modern rules of statutory interpretation. This echoes *LeBlanc*, which also set its decision on the principles of statutory interpretation (at paras 24–25). From here, the commonalities between the B.C. and New Brunswick appeal courts' analyses end.

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The word 'disbursements' in its grammatical and ordinary meaning encompasses any out-of-pocket expense. The Court held that the word itself must be constrained by the context of Rule 14-1(5) and guided by the purposes of a costs regime.

**The Costs Regime**

The Court outlines the history of recovery of costs and pre-judgment interest, notably that costs recovery is a legislated phenomenon. Pre-judgment interest on monetary awards was not recognized at common law either. Today, Section 1 of the *COIA* allows for pre-judgment interest to a pecuniary judgment and on special damages. Given these historical points, Harris J.A. draws the following conclusions: (1) the legislature did not intend to allow the recovery of out-of-pocket interest expenses as disbursements; (2) nothing in the evolving language of the rule ever suggested interest expenses had become recoverable; and (3) the *COIA* does not support out-of-pocket interest expenses as recoverable disbursements.

Cumulatively, these factors satisfy the Court that the legislature did not intend to have interest expenses awarded as disbursements. Further, the Court finds no principled distinction between losing the use of money, where a party pays as she or he goes, and the loss of out-of-pocket interest expense. The Court notes that losing the use of money is just as much a loss as is incurring interest.

**Disbursements Must Arise Directly from the Proceeding**

Under Rule 14-1(5), the Court finds the words "in the conduct of a proceeding" do not contemplate the financing of a proceeding. To be recoverable, disbursements must arise "directly from the exigencies of the proceeding" and be directly related to the "management and proof of allegations, facts and issues in litigation". Interest expenses arise from unrelated causes, such as a party's financial circumstances.

The Court notes that its interpretation of Rule 14-1(5) flows naturally from a purposive understanding of the costs regime. While indemnification is a purpose of awarding costs, the Court observes that a costs regime provides only partial indemnity. Another purpose of costs is to shape awards in a predictable and consistent manner. The Court warns that awarding interest expenses as recoverable disbursements would undermine this latter objective, as costs would depend on any given party's particular circumstances and not the nature of the case itself. The Court notes further that a costs regime is not a tool for securing access to justice. Finally, the Court rules that awarding interest as an expense would lead to a "transfer of resources between classes of parties," separate from the objective to make an award on the particular case as between winning and losing parties.

The Court draws on *Walker* v. *Ritchie*, [2006] 2 SCR 428, in which Justice Rothstein made several observations about the purposes of a cost regime. In *Walker*, the Court highlighted the difficulty of measuring the risk of litigation when private agreements between the one litigant and a private third party obfuscated the opposing litigant's ability to gauge its exposure to costs. Further, Rothstein J. expressed concern that awarding what was a risk premium in that case would "distort the incentive structure" of a costs regime.

**Comment**

In his closing sentences, Harris J.A. acknowledges that two other appellate courts in Canada have recognized the legitimacy of awarding out-of-pocket interest expenses as recoverable disbursements. Both of these courts have clearly enunciated the access to justice rationale in concluding that interest may be recoverable.

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The notion that access to justice may justify recognizing interest on out-of-pocket expenses is dealt with only indirectly by the B.C. appeal court. Harris J.A. instead quotes the following passage from *Walker*:

> "There are a number of other alternatives that bring these cases to trial. For example, plaintiffs in such cases may qualify for some form of legal aid, receive funds to pursue the litigation from a private source, find counsel to take on the case on a *pro bono* basis, or, in rare cases, be entitled to an interim costs award. While there may be a plaintiff who is unable to secure one of these alternatives, the costs scheme does not aim at perfection"

While it can be argued that this perspective does not fully appreciate the reality of access to legal aid and *pro bono* legal work, the Court is unpersuaded. It concludes that "unsuccessful defendants are not required to subsidize unsuccessful plaintiffs' cases or the costs of running a plaintiff's side personal injury practice". In the future, plaintiff's counsel will be expected to absorb interest on out-of-pocket expenses as the cost of doing business and litigation financiers cannot look only to unsuccessful defendants to fund the risk on their entire portfolio of potentially successful and unsuccessful lawsuits.

This decision is a wholesale rejection of the rationale driving much of Ontario, New Brunswick, and prior B.C. case law on this topic. However, the B.C. Court of Appeal has aligned itself with other courts like Alberta's Queen's Bench and jurisdictions further abroad, such as England and South Australia.

One should also recall that the Chief Justice of the S.C.C. has declared access to justice to be one of the cornerstones of the rule of law. Additionally the S.C.C. has recently overruled the B.C. Court of Appeal in *Trial Lawyers Association of British Columbia* v. *British Columbia (Attorney General)*, 2014 SCC 59. In that decision, the S.C.C. found unconstitutional B.C.'s requirement for hearing fees because they impeded access to justice. For these reasons, these authors believe that an appeal to Canada's highest court is probable.

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