

DIRECTORS' AND OFFICERS' LIABILITY UPDATE

APRIL 2011

COURT APPROVES AGREEMENT FOR IRISH COMPANY TO FUND A CANADIAN SECURITIES CLASS ACTION

In *Dugal v. Manulife Financial Corporation et al*, Justice Strathy released interim reasons on March 21, 2011, conditionally approving a funding agreement pursuant to which an Irish corporation known as Claims Funding International PLC ("**CFI**") agreed to indemnify the plaintiffs against their exposure to costs in return for a 7% share of any recovery in the litigation. It appears that Justice Strathy's decision is the first in Ontario to approve this sort of third party funding agreement.

The Facts

The plaintiffs commenced a securities class action asserting secondary market liability against Manulife Financial Corporation ("**Manulife**") and various of its officers and directors. The plaintiffs alleged that the defendants made misrepresentations regarding Manulife's risk management practices in its public disclosure documents, which artificially inflated the price of Manulife's shares. The plaintiffs further alleged that once Manulife

corrected these alleged misrepresentations, its share price dropped significantly.

The Funding Agreement

The plaintiffs entered into a funding agreement with CFI pursuant to which CFI will pay any adverse costs awards against the plaintiffs and advance up to \$50,000 for disbursements in return for a 7% commission on any settlement or judgment in the action. The plaintiffs then brought a motion to have the court approve the funding agreement.

According to Justice Strathy's interim reasons, the material terms of the funding agreement are as follows:

- CFI is entitled to a commission of 7% of the amount of any settlement or judgment, after deduction of the fees and disbursements of class counsel and administrative expenses.
- The 7% commission is subject to a "cap" of \$5 million if the resolution occurs at any time prior to the filing of the plaintiffs' pre-trial conference brief and \$10 million if the resolution occurs at any time thereafter.

BILL 198 BACKGROUND

The passage of Bill 198 introduced a statutory regime that provides a statutory cause of action for misrepresentations made in the secondary market. Bill 198 was meant to promote accurate continuous disclosure and deter misrepresentations in the secondary market. To protect potential defendants, the legislation included a requirement that a potential plaintiff obtain leave from the Court before commencing an action under the statute. This leave requirement directed the Court to act as a gatekeeper and grant leave to proceed only when claims are brought in good faith and have a reasonable possibility of success at trial.

- CFI will pay \$50,000 towards the plaintiffs' disbursements.
- Class counsel are required to advise CFI of any significant issue in the proceeding, including prospects of success, strategy and quantum, and class counsel are required to respond to any reasonable request by CFI for information about the proceedings.
- CFI acknowledges that the representative plaintiffs are to instruct counsel and that counsel's duties are to the plaintiffs and not to CFI.
- The plaintiffs must conduct the proceeding in a manner that avoids unnecessary costs and delay and must provide full and honest instructions to class counsel.
- CFI is not required to provide funding for any appeal unless it independently decides to do so.
- CFI is only entitled to terminate the agreement if the plaintiffs breach their obligations referred to above or appoint different lawyers to replace class counsel.
- The agreement is governed by the laws of Ontario and Canada and is subject to the exclusive jurisdiction of the Ontario courts.
- The agreement does not come into effect unless approved by the court.

The Defendants opposed the approval of the funding agreement on the basis that (i) the agreement may be champertous and unlawful under an *Act Respecting Champerty*, RSO, 1897, c. 327 (the "**Champerty Act**"); (ii) CPI is an Irish company and there is no

evidence that it has any assets in Canada to actually pay an adverse cost award; and (iii) the agreement does not protect any confidential information that is or may be shared with CFI.

Justice Strathy first determined that the Court has broad jurisdiction under section 12 of the *Class Proceedings Act* ("**CPA**") to "make any orders it considers appropriate respecting the conduct of a class proceeding to ensure its fair and expeditious determination and, for the purpose, may impose such terms on the parties as it considers appropriate." Relying on that section of the CPA and finding that one of the court's functions in class proceedings is to protect prospective class members, Justice Strathy determined that the Court has jurisdiction to approve such an agreement, even before a class has been certified.

Justice Strathy then addressed the question of whether the funding agreement was unlawful under the *Champerty Act*. Justice Strathy determined that a funding agreement will be champertous if it exacts "an unfair price for the funding agreement, with resulting unfairness to the litigant." Justice Strathy determined that the funding agreement was not champertous and that it should be approved because:

- (i) the funding agreement "helps promote one of the

important goals of the CPA – providing access to justice" by insulating representative plaintiffs from significant cost awards which are a deterrent to any individual serving as a representative plaintiff;

(ii) there was no evidence that CFI incited or provoked the litigation against Manulife and, from the evidence, it appeared that the plaintiffs intended to proceed with the litigation before they even began discussing a funding agreement with CFI;

(iii) although the funding agreement requires the plaintiffs to provide information about the litigation to CFI, the funding agreement is clear that it is the representative plaintiff who will instruct counsel;

(iv) the commission under the funding agreement is, according to Justice Strathy, reasonable and consistent with the 10% commission that would be payable if the plaintiffs applied for funding through the Class Proceedings Fund.

Justice Strathy, however, identified two concerns with the funding agreement that he required the plaintiffs to address before issuing final reasons approving the funding agreement. First, Justice Strathy recognised that CFI has no assets in Canada. Justice Strathy stated that he "will not approve the agreement without adequate security being provided." It appears to be an open question as to whether CFI and the plaintiffs will merely be required to provide the Court with

evidence that CFI will be able to satisfy any adverse costs awards or whether CFI will be required to actually post security for costs.

Second, Justice Strathy directed the plaintiffs to draft and incorporate guidelines into the agreement to ensure that any information that is provided to CFI

is protected.

Aside from those outstanding issues, Justice Strathy stated that he was "prepared to approve the funding agreement."

Conclusion

Justice Strathy's decision to approve a third party funding agreement is significant. It

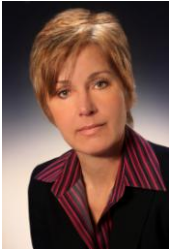
appears that these sort of agreements will encourage class actions and allow representative plaintiffs and/or their counsel who may not otherwise be able to fund a securities class action to obtain funding from alternative sources, which can only increase the amount of class proceedings in this area.

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