Jury still out on third-party class action funding

BY MICHAEL McKIERNAN
Law Times

A growing number of class actions involving third-party funders is helping lawyers fill in the many blanks in the law surrounding the practice, according to a partner at Stockwoods LLP.

Speaking at The Advocates' Society's second annual securities symposium on Sept. 13, civil litigator Aaron Dantowitz told the audience that securities class actions have become the favoured forum for third-party funders with three of the four reported decisions addressing agreements coming out of securities cases.

"This is an emerging phenomenon in Ontario, but there are some lessons that can be distilled from the limited case law we have so far," said Dantowitz.

Funders that have established themselves in the field include Canadian funder Bridgepoint Financial Services Inc. and Ireland-based Claims Funding International PLC. Both offer services that include indemnification for adverse costs awards and financing for disbursements and legal fees in exchange for a cut of any final settlement.

Despite operating in the same realm as the Law Foundation of Ontario's class proceedings fund, there's plenty of room for private *players in the class actions funding* market, according to Dantowitz.

He said most claimants will need funding of some kind and that funders seem to have settled on a commission of about seven per cent, a number that's well below the 10-per-cent levy charged by law foundation's fund. In any case, the law foundation doesn't grant funding to all claims and class counsel are sometimes unwilling to fill the gap.

"The economics of class actions, of course, are that the individual claim of the representative plaintiff or any class member is out of proportion typically to the costs of litigation and particularly to the exposure the representative plaintiff faces if the case is unsuccessful," said Dantowitz.

"The idea of passing the hat around class members trying to help out the representative plaintiff typically isn't a realistic option, so third-party funders have entered the fray."

Recent costs awards in *Smith v. Inco*, in which the court awarded $1.77 million to Inco Ltd. for the trial of the common issues, and *Martin v. AstraZeneca Pharmaceuticals PLC*, in which the court ordered a plaintiff indemnified by her class counsel to pay $700,000 for a failed certification motion, have reinforced the potential jeopardy for failed claimants.

"These are very real risks that plaintiffs face if they're unsuccessful and typically the amount they stand to gain personally doesn't compare to those amounts," said Dantowitz.

Claims Funding International's agreement with a group of former investors suing Gildan Activewear over secondary-market share purchases was the first to come before the courts in 2009 when Superior Court Justice Lynne Leitch addressed the concern that such agreements could be champertous.

Drawing on the Ontario Court of Appeal's decision in *McIntyre Estate v. Ontario (Attorney General)*, which concerned contingency-fee agreements between lawyers and clients, Leitch cleared the way for third-party funding agreements.

"It was concluded by the court in *McIntyre* that contingency agreements are not, per se, champertous. Similarly, I think the same comment can be made respecting third-party funding agreements," Leitch wrote, adding that an assessment of the motives underlying each agreement would be necessary.

Subsequent judgments have adopted the same reasoning by conducting case-by-case assessments of the fairness and reasonableness of the funder's fee to determine whether an improper motive exists.

Excessive compensation would constitute an improper motive, according to Dantowitz, who noted it has "become clear that the third-party funding agreements are not categorically illegal on the basis that they are champertous."

In the *Metzler Investment v. Gildan Activewear* case, Leitch actually declined to approve the agreement that provided for a seven-per-cent commission on any "resolution sum."

Since the case was still in its early stages and there was no cap on the funder's compensation, Leitch determined it was "impossible to conclude that this agreement will not amount to 'over compensation' to the extent that it is unreasonable and unfair to those who will bear its expense."

In her decision rejecting the agreement, Leitch also gave guidance about the extent of the influence funders can exercise over the litigation. Leitch shot down a termination clause that allowed the funder to walk away at any time with notice and without cause as well as another provision that required class counsel to immediately report settlement discussions to Claims Funding International. Neither clauses have reappeared in subsequent cases, according to Dantowitz.

"CFI has the right to be informed but has no right to instruct class counsel or otherwise control the litigation," Leitch wrote.

The most recent securities case to see a third-party funding agreement arose in May of this year when Ontario Superior Court Justice Paul Perell approved an agreement between Claims Funding International and the plaintiffs in *The Trustees of the Labourers' Pension Fund of Central and Eastern Canada v. Sino-Forest Corp.* This time, the commission percentage and cap were both on a sliding scale, depending on when the action settled, with the funder's maximum payday standing at $10 million. The judge also required the funder to pay security for costs based on its lack of assets in Canada.

In *Fehr v. Sun Life Assurance Co. of Canada*, the only non-securities class action agreement reported on, the plaintiffs failed in an attempt to keep the agreement behind closed doors.

Despite the increased volume of cases, Dantowitz said there are "a lot of things we still don't know both in terms of the substantive law and the procedure that applies to approving these types of agreements." LT